

## Concept of Revenue, Expenses and Liabilities in Accounting for Zakat, Waqf and Baitulmal in Malaysia: An Analysis from Shariah Perspective

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### ABSTRACT

*Revenue, expenses and liabilities are an important concept in current accounting practices. These concepts are applied in accounting standards where this standard serves as a guideline for a company or organization in preparing and presenting income, expenses, assets and liabilities in accordance with the standards set by the International Accounting Standards Board (IASB). The accounting standards issued by this international body refer to conventional accounting standards. In Malaysia, the State Islamic Religious Council (MAIN) as the trustee for Zakat, Waqf and Baitulmal uses standards issued by the Malaysian Accounting Standards Board, Private Entity Reporting Standards (PERS) and best practice guidelines by the National Audit Department (Malaysia) (JANM). These two documents are used as references in the preparation of financial reporting for MAIN. However, there are problems in terms of implementing these concepts for Zakat, Waqf and Baitulmal with current accounting standards. This is because current accounting practices are different from the concepts of revenue, expenses and liabilities adopted by Zakat, Waqf and Baitulmal according to Islamic law. This study aims to analyze the concept of revenue, expenses and liabilities in Zakat, Waqf and Baitulmal accounting from Shariah perspective. The design of this study is qualitative. The method of content analysis was used to analyze data from sources such as classical Fiqh books. The findings show that there is a difference between the concept of revenue, expenses and liabilities in Zakat, Waqf and Baitulmal accounting in the Islamic context. The study is expected to help the parties involved to develop accounting standards for zakat, waqf and baitulmal which are compliant with Shariah.*

*Keywords: Islamic accounting standards, Zakat, Waqf, Baitulmal*

### INTRODUCTION

The Malaysian Constitution, clause 3 (4) states that Islam is under the jurisdiction of the Sultan and the King for the monarchy and under the authority of the King of the States for the non-monarchical states, such as Malacca, Penang, Sabah, Sarawak and the Federal Territory. This religious affair is contained in the Ninth Schedule of the Malaysian Constitution. Among them is Zakat, Waqf and Baitulmal (Azizah Dollah, 2012). By implication, the State Islamic Religious Council (MAIN) in each state is responsible for managing zakat, waqf and baitulmal matters in Malaysia

and this includes the accounting aspects of the three entities. Accounting or in Arabic *Al-muhasabah*, is a process involving recording activities, classifying, analyzing and interpreting trading activities in a logical form or in accordance with the purpose of providing financial information before making a decision (Mohd Abdullah Jusoh & Hazianti Abdul Halim, 2009). In summary, the accounting for zakat, waqf and baitulmal is the measurement, disclosure or the provision of certainty about the information that helps the MAIN to decide on the allocation of resources for the three entities. In the Islamic economic system, a Shariah-based accounting system

must have a scope that not only affords its organization, but also takes into account the interests of the general public. Basically, this accounting system is responsible for the community and because of the ethics of society influenced by the Shariah demands, then monitoring the activities of the organization so that it is in harmony with Islamic law is an important responsibility. Each of these activities should be measured in terms of law (*halal-haram continuum*) and any sharia contradictory measures have no value (Mohd. Khir Ashari, 1991).

Some accounting theorists feel that Western accounting adopt narrow marginalization, utilitarian economic principles and assumes liberal democracy as the basis of society (Lehman, 1992). On the other hand, Islamic accounting can be regarded as a comprehensive accounting process for providing appropriate information, which is not limited to

financial data to stakeholders in an entity only. In fact, the application of the Islamic accounting system will ensure that stakeholders in a moving entity continuously within the limits of Islamic law and at the same time, can achieve the socioeconomic objectives of the entity (Bala Shanmugam & Vignes Perumal, 2005). Among the objectives of Shariah accounting is to produce human beings who have the principle of *Tauhid* and obey the provisions of Allah. Therefore, the development of values of truth, honesty and justice must be practiced in Islamic accounting. As an implication, generally accepted accounting measures (standards) can only be implemented as long as it does not conflict with Islamic law (Abdullah Said & Normala, 2011). In summary, the comparison between conventional accounting and Islamic accounting can be illustrated as follows in Table 1.

**Table 1.** Similarities and Differences Between Conventional Accounting and Islamic Accounting

Element	Anglo-American Accounting Model	Islamic Accounting Model
Economic approach	Micro	Macro
Society-based main user	Investors and accounting policy lenders	Country, Management, Objectives-oriented value
Asset Assessment	Previous Cost Price	Current Price
Income Determination	Revenue-Expenses approach	Asset-Liability Approach
Time value of money	Yes	No
Time Frame	Yes	Yes
Main Focus	Income Statement	Balance Sheet
Theoretical Concepts	Entity Theory	Theory of Ownership
Accounting postulates (assumptions)	Based on Income	Based on Shariah Law
Fixed Interest	Yes	No
Legal Orientation	<i>Common Law</i>	Shariah Law
Accounting Ethics	Professional Ethics	Religious Ethics
Stock Exchange Market	Yes	Yes
Bon	Yes	Yes, on condition
Accounting Approach	Value Approach	Events Approach
Business dichotomy and moral personal	Yes	No

Source: Taheri (2003)

Meanwhile, MAIN as a statutory body is subject to the PA Treasury Circular 3.1 regarding the applicable accounting standards. Hence, all the State Islamic Religious Council (MAIN) has adopted the Private Entity Reporting Standards (PERS) issued by the Malaysian Accounting Standards Board (MASB) in preparing the financial statements. However, these standards cannot meet the requirements for creating MAIN account and transaction reporting related to zakat, waqf and baitulmal accurately (Maliah, et al., 2016). This problem occurs because the concept of revenue, expenses and liabilities implemented are different from the concepts adopted by zakat, waqf and baitulmal according to Islamic law. Therefore, this article attempts to analyze the concept of revenue, expenses and liabilities in accounting for zakat, waqf and baitulmal from Shariah perspective to assist in the development of accounting standards for Shariah-compliant zakat, waqf and baitulmal.

#### CONCEPT OF REVENUE, EXPENSES AND LIABILITIES IN ISLAM

In general, there is no specific discussion about the concept of revenue, expenses and liabilities in Islam by the classical Muslim jurists. Discussions relating to the concept of revenue, expenses and liabilities are discussed separately in debates on property theory and the theory of ownership in Islam. Therefore, the theory of property and ownership in Islam should be clarified in order to understand the concept of revenue, expenses and liabilities in Islam.

##### *Discussion about the Theory of Property in Islam*

In terms of language, property or assets can be defined as items that are owned and controlled by a person, whether in the form of objects that can be touched (*ain*)

or benefit. For example, property in the form of objects that can be touched (*ain*) is gold and animals. Whereas, the example of property in the form of benefits is dwelling in the house and riding on horses. Based on the definition of this property, it is understandable that any unmanageable items such as trees in the forest, fish in the water or birds in the air are not classified as property (Zaydan, 2001). From the point of the term, the jurists differed in the terms of property and divided into two groups. Muslim jurists apart from the Hanafi school expressed the opinion that property is a valuable item. If the item is damaged, then the person who spoils the item must pay compensation. Muslim jurists from the Hanafi school also expressed their opinion that the property is an object that can be controlled and taken advantage of them. According to them, property is also restricted to physical objects and substances that can be felt (tangible). Therefore, they asserted that rights and benefits are not considered as property, otherwise considered as ownership. This view conflicts with the view of other schools because they thought that the rights and benefits are considered as property. This is because the purpose of the property itself is not the substance, but the benefits of the property. This view of the jurists implies the laws of seizing, lease and inheritance. For example, in the case of seizing, if a person seizes the garment and uses it, then for a moment he returns the garment to his owner, he shall compensate his beneficial value to the garment according to the jurists other than the Hanafi school. On the other hand, according to the Hanafi school, he does not have to pay compensation for the garment unless the seized garment is a donated property (*waqf*) or an orphan's property (Wahbah al-Zuhayli, 2009).

In the meantime, assets in accounting term can be defined as any item that may benefit future economic benefits and potential services to an entity (FRS, 2010). Based on this definition,

there are three important factors to be taken into account on the assets, namely; control factors need to be in the asset, the ownership issue does not take into account and the value of the asset must be measurable. Therefore, a person may not own the asset, but if he/she controls the asset, he/she owns the asset. Similarly, if the asset cannot be measured or evaluated, it will not be considered an asset. Assets can be divided into two types, namely current assets and non-current assets. Current assets are assets that can be converted into cash within a short period of time, usually a year or a period of accounting. For example, banks, cash, stocks, debtors, previous expenses, accrued revenue and others. Meanwhile, non-current assets are long-term assets that are used to run a business over a long period of time. For example, vehicles, machines and others. It is not intended for resale in the hope of gaining profit (not for business profits). The definition of assets in conventional terms differs from the definition of assets in Islam because Islam recognizes the ownership of the assets owned even if the ownership is imperfect. In fact, the concept of assets in Islam is broader and more general than the concept of assets in conventional accounting terms.

Revenue is anything derived from business activities that add value to assets through the sale of goods or services. FRS 118 defines revenue as a gross inflow of economic benefits over the accounting period from an entity's ordinary activity, namely increase in assets or decreases in liabilities resulting from the increased equity due to various factors other than new capital contributions (FRS, 2010). Easily, the money received or to be received in the future by the MAIN can be categorized as revenue. The revenue is divided into two, namely business operating revenue and non-business operating revenue. Business operating revenue is derived from the main business activities such as sales of goods, services, property rental and others. Non-business

operating revenue is derived from matters unrelated to core business activities such as bank deposit interest, rental payments received, dividends received, profit from the sale of non-current assets.

MASB9 defines expenses as an outflow of assets or reduction in economic benefits in the management of a business. In simple terms, expenses are the cost of services or goods paid or to be paid by MAIN when conducting business with the purpose of obtaining revenue for a business. Business operating expenses are expenses involved in daily business operations such as general expenses, salaries, advertisements, paid rent, and others. Meanwhile, non-business operating expenses are expenses that are not associated with normal daily operation of the business, such as loan interest, loss on disposal of assets, loss from fire, theft and so on.

Liability is a business obligation or debt that must be settled by the creditors in accordance with the agreed agreement (MAFSB9). In simple terms, liability can be defined as business debt to be settled by the MAIN with money, goods, or services. There are two types of liability, namely; non-current liabilities (long-term liabilities) which are repayable loans over a long period of time (more than one accounting period) such as loans, collateral loans, debenture mortgages and so on. Current liabilities (short term liabilities), which are repayable in a short period of time (less than one year) such as bank overdraft, accrued expenses, previous revenue, creditors and others. The owner's equity is the owner's investment in the business. In this context, business liabilities to owners is the amount of capital invested by the owners in the business and profits derived from business activities. Profit will increase the owner's equity, while losses and withdrawals will reduce the owner's equity.

### *Discussion about the Theory of Ownership in Islam*

The word of origin is derived from the word *al-milk*, which means the relationship between man and property recognized by the Islamic law, in which the property is devoted to the man and with this recognition allow him to administer the property according to his will as long as it does not conflict with the Islamic law (Wahbah al-Zuhayli, 2009). *Majalah al-Ahkam al-Adliyyah* (Article 125) defines property as belonging to a person, whether it is a form of goods (*ain*) or benefits. The word ownership also refers to something that is owned, for example, someone says "this stuff is mine", which carries the connotation of "mine". Based on this point, it can be concluded that the view of Hanafi's school on ownership is more general. They considered that the benefits and rights are owned, not property. Thus, according to the Hanafi school, ownership is more common than property (Md. Akhir, 1994).

In reality, the property can be owned. However, in some cases, there is a barrier in accordance with the Islamic law that causes it to not be given ownership. The Muslim jurists have divided the property into three categories; namely property that cannot be owned and cannot be received as a property devoted to the general benefits of the community, such as roads, bridges, rivers, railways, museums, public libraries and so on, property that can not be owned except by Islamic law such as waqf property and property of baitulmal and property which may be owned and given property, that is, other than two types of property mentioned (Zaydan, 2001).

The jurists also divide ownership, according to its kind. According to them, ownership is divided into two types, namely perfect ownership and imperfect ownership. Perfect ownership is the ownership of the substance and the benefits of a property. Among the features

of the perfect ownership is absolute, without any limitation of time as long as the property remains, the owner is free to make transactions in his property such as using, increasing capital, investing, promoting, and administering the property according to his will. Imperfect ownership is the ownership of the property alone or the ownership of its benefits. Having benefited only known as *haq al-intifa'* (right to gain benefit). Having these benefits can be divided into two parts, namely; *haq syakhsi* (individual rights) and *haq 'aini* (property rights), which means the right to always follow the substance of the property, regardless of the person taking advantage of the property (Zaydan, 2001). *Haq Irtifaq* is the right set forth in immovable property for the benefit of other immovable property owned by others. This right is a perpetual right as long as the property remains without regard to its owners such as drinking rights, neighbors, rights to use the roads, the right to water and others (Wahbah al-Zuhayli, 2009). Among the characteristics of imperfect ownership is that it can accept the time limit, the place and the nature of it when it is implemented. This is contrary to the category of perfect ownership in Islam.

In Islam, one can possess the property (*ain*) only and at the same time the benefits of such property are owned by another person. For example, Ahmad expressed his desire to allow Ali to live in his home for three years. In this case, if Ahmad dies and Ali has received the will, then the house becomes the heir of inheritance and Ali can benefit during the prescribed period of three years. In this situation, the heirs are required to allow Ali staying in the house and if the heirs refuse to do so, Ali is entitled to make a legal claim (Zaydan, 2001). Similarly, in the ownership of the only benefits like Waqf. Waqf recipient or beneficiaries may benefit from Waqf properties and allow other individuals to use them on condition of obtaining permission from Waqf giver.

There are some causes or reasons for the complete ownership, namely the mastery of something which is a must, through contract, or the replacement (*khalfiah*) and or through a child born of something that is owned (Wahbah al-Zuhayli, 2009).

#### ZAKAT, WAQF AND BAITULMAL

Zakat is included in the third pillar of Islam and is an obligation that has been established by the Islamic law and has a direct connection with the Islamic economic system. Zakat is one of the main pillars that serve as the basic factor in the distribution of wealth in the Islamic economy. Waqf is the practice of charity that is highly demanded by Islam. The power of waqf can be proved through a very important role in socioeconomic development of the Ummah which includes various aspects such as the Islamization of space, infrastructure development, eradication of poverty, health and others. Meanwhile, Baitulmal is a property and a financial institution that collects property owned by all the people who live and settle under the rule of the Islamic government. In summary, these three institutions work on the basis of the rules set out by the Islamic law.

In the context of Malaysia, Article 74 of the Federal Constitution places, religious affairs (including zakat, waqf and baitulmal) under the authority of the MAIN except for the Federal Territory of Kuala Lumpur, Labuan and Putrajaya as stipulated in the Ninth Schedule (Article 74, 77) List 2 - List of States as follows:

*“Except for the Federal Territory of Kuala Lumpur, Labuan and Putrajaya, Islamic law and personel and family law of persons professing the religion of Islam, including the Islamic law relating to succession, testate and intestate, betrothal, marriage, divorce, dower, maintenance,*

*adoption, legitimacy, guardianship, gifts, pertitions and non-charitable trusts; waqf and the definition and regulation of charitable and religious trusts, the appointment of trustees and the incorporation of persons in respect of Islamic religious and charitable institutions opertaing wholly within the state; Malays customs; zakat, fitrah and Baitulmal or similar Islamic religious revenue; mosques or any Islamic public places of worship.....”*

The provisions in the Federal Constitution clearly state that MAIN has executive powers in relation to Islamic religious affairs and is a trusted institution for zakat, waqf and baitulmal in Malaysia.

#### *Zakat in Islam*

In terms of language, zakat means to grow and increase. Meanwhile, in terms of Shariah law, zakat is defined as the mandatory right on the property. The jurists have different views on the proposed definition of charity in accordance with Islamic law. The jusrits of the Shafi’i school says that zakat is a name for goods manufactured for property or body (human being for zakat fitrah) to certain parties. Meanwhile, the jurists of the Hanbali school give the definition of zakat as a mandatory right to certain property to a certain group at a certain time. The jurists of the Hanafi school assumed that zakat is the granting of a right of ownership over certain property to a certain person who has been determined by the Islamic law, solely for Allah. The jurists of the Maliki school also provide a definition of zakat, which is the process of removing certain part of the particular property that has reached nisab to the person entitled to receive, if the ownership, haul (enough one year) has been completed, in addition to minerals,

crops and treasures. Based on the meaning of zakat submitted by the Muslim jurists, it is clear that zakat refers to the granting of zakat itself (granting the mandatory property rights) to the asnaf groups which have been determined by the Islamic law (Wahbah al-Zuhayli, 2009).

There are two types of obligatory zakat, namely *zakat fitrah* and *zakat harta* (zakat on property). *Zakat fitrah* is a mandatory payment for every Muslim individual from Ramadan to 1 Syawal. *Zakat harta* (zakat on property) is a mandatory payment when the property reaches the rate and period set by the Islamic law. The property which is subject to zakat is gold, silver, business, income, stock, money, savings, agriculture and minerals. The zakat rate varies according to fixed assets and property changes. For property changes, the rate of zakat charged is between 1.25% to 2.5%. Meanwhile, for fixed assets, the rates charged are 5%, 10% and 20%. The rate used in the calculation of zakat for business, savings and income is 2.5%.

Zakah is distributed to eight groups of asnaf, namely the poor (*fakir*), needy (*miskin*), *amil*, *ar-riqab* (slave), *al-gharimin* (the indebted), *fi sabilillah* and *ibn sabil*. This is in line with the Quran, in Surah At-Taubah, verse 60 which means; “*Zakat expenditures are only for the poor and for the needy and for those employed to collect zakat and for bringing hearts together (for Islam) and for freeing captives (or slaves) and for those in debt and for the cause of Allah and for the (stranded) traveller – an obligation (imposed) by Allah. And Allah is Knowing and Wise*”. The jurists have different interpretations of each group that are eligible for zakat.

Zakat accounting (*Muhasabah al-Zakah*) is a field of accounting knowledge to determine and assess the property of zakat, determine its rate, make the assessment of the zakat imposed, collect and distribute the zakat property that is collected to zakat recipients based on the

rules prescribed by the Islamic law (Husain Sahatah, 2003). Zahri Hamat (2013) concludes that there are five phases involved in zakat accounting. The first phase, determining the assets that are obliged to pay zakat. The second phase, assessing the assets required to pay zakat. The third phase, determining the appropriate zakat rate. The fourth phase, distributing the zakat collection to the zakat recipients and the fifth phase, providing a report on the collection and distribution of zakat to the authorities.

From the perspective of accounting, zakat also has a standardized procedure beginning from the beginning of its obligations set by Islam. This procedure is fixed and unchanged except in the aspect of its implementation process. The basis of zakat accounting is enforced on a regular and comprehensive basis for all Muslims. Thus, the obligation of zakat continues to be a debt to Allah s.w.t if it is not implemented. In fact, this debt will not be eliminated only after death, until the heirs are required to settle the debt using the property of the deceased before distributing the property of the heir (*faraid* property). According to Ezani Yaakub (2011), the accounting principles of zakat can be summarized as follows:

1. The basis of valuation based on current price. This assessment should be carried out in accordance with the prescribed haul period and on the due date of the round of haul or the date of commencement of zakat calculated.
2. One year, according to the Islamic calendar (*Qamariah*) should be used for those subject to haul period. This is based on the hadith from Rasulullah s.a.w; “*There is not Zakat on wealth until Haul (one year) has passed*” (Ibn Majah).
3. Year of production. Everything must be calculated within the haul of the year only. Therefore, all production proceeds over the period of the zakat

account for the relevant Qamariah year (Islamic calendar) need to be brought to the next year.

4. Based on nisab predetermined either 85 grams of gold (20 Dinars) or 595 grams of silver (200 Dirhams). It can then be valued with local currency according to the current value of gold or silver, livestock and agriculture. Nisab is in accordance with a predetermined formula.
5. Imposed on net income rather than gross income. Deductions on assets.
6. For zakat income, reasonable basic needs should be deducted according to current or local arrangements. The value or sum of the deductions will always change. The change policy is generally subject to the jurisdiction of a country.

The obligation of managing zakat is a trust that the manager has to carry out with full responsibility and integrity. Apart from collecting, zakat funds are also required to be distributed according to the rules set by Allah. The organization responsible for the zakat fund is obliged to issue them and distribute them to those entitled. From the aspect of the distribution of zakat funds, Allah has clearly stated it as a guideline to be followed by Muslims. The zakat funds donated by those who are qualified shall be distributed according to the eight groups of asnaf which have been determined by the Islamic law.

#### *Implementation of Zakat in Malaysia*

In Malaysia, zakat is included in the jurisdiction of state administration, which has the effect of establishing a separate zakat law for every state in Malaysia. The authority to administer zakat in each state is subject to the laws of the respective states. The zakat laws of each state are usually contained in the State Islamic Administration Enactment (EPAIN) and until 2018, only two states in Malaysia have the Special Enactment of Zakat,

namely Kedah and Sabah. Among the matters listed in the zakat administration clauses are the fundamental system for the collection of zakat, zakat asnaf, the law for not paying zakat or the payment of zakat through unofficial channels (unless stated otherwise) and some other rules. Until now, there is no method or regulation in relation to the distribution of zakat (Hasan Baharom & Ezani Yaakub, 2011).

There are several principles of zakat fund distribution in Islam. These principles are trust, *isti'ab* (zakat funds must be allocated to all eight assassinated groups and based on the priority policy decided by the body affected. The concept of transfer to other asnaf must refer to the needs and the excess of funds accumulated), *ikhtisas* (zakat funds must be allocated to eight recipients (*asnaf*) in their respective states), *haq* (zakat funds accumulated must be allocated immediately based on the current requirements to each asnaf in physical form or benefit), *muraqabah* (zakat funds distributed shall be monitored and controlled), *kifayah* (based on the principle of actual needs according to asnaf and their income does not exceed the limits of kifayah), *fawran* (the zakat manager should ensure that the names of the asnaf are accurate so that the distribution can be submitted immediately and to the actual asnaf), *istiqlal* (all zakat funds accumulated should be separated in separate accounts from other accounts), *ihsa'* (the appropriate distribution has been reviewed, monitored and certified by the acceptance of the distribution to asnaf), *tarshih* (zakat payers are required to nominate zakat recipients to *amil*), priority (each distribution must give priority to the poor, needy and *amil* before distributing to other asnaf) and *tamlik* (distribution of zakat funds conceptualizes ownership of each asnaf).

In summary, the distribution of zakat in Malaysia can be done through two methods. First, self-distribution; and second, productive distribution. Self-

distribution is distributed in the form of monthly remuneration, special help in home rental payments or educational support. This type of help is aimed at helping the poor and needy survive to fulfill the basic needs. Whereas, productive distribution is distributed in the form of capital either human capital or business. Human capital assistance is provided in the form of skills training, while business capital in cash and equipment. Business capital assistance aims to help the poor and needy change their lives for the better, that is, from zakat recipients to zakat payers (Rosbi Abd. Rahman, Sanep Ahmad & Hairunnizam Wahid, 2008).

Assistance given to each asnaf is different according to the state in Malaysia as the interpretation of these groups is different according to the fatwa in their respective states. For example, the definition of asnaf *al-Riqab* is different according to the State current fatwa. Penang, Perak, Malacca and Johor for example, decided not to distribute zakat to asnaf *al-Riqab* because the interpretation of *al-Riqab* definition made by fatwa in each state only restricts the liberation of slaves. However, there are states like Terengganu, Pahang, Negeri Sembilan, Selangor and Perlis, which expand the interpretation of asnaf *al-Riqab* by distributing zakat to eradicate ignorance, social problems and faith (Nur Anisah Nordin & Wan Mohd Khairul Firdaus Wan Khairuldin, 2017).

### *The Concept of Waqf in Islam*

The Waqf in Arabic is derived from Waqf, which means holding something. Holding something that is meant here is to hold a property solely because of Allah for public interest (Al-Ansari, t.t). There are various definitions of Waqf that have been raised by the Muslim jurists such as al-Qurtubi, al-Sharbini and Ibn Abidin. Imam al-Qurtubi said that the Waqf is to produce wealth and the benefits of belonging to a

path blessed by Allah to get close to Him (Al-Qurtubi, 1980). Al-Sharbini stated that Waqf means holding a property or goods that can be utilized on the basis of its physical condition remains in accordance with the conditions permitted by the Islamic law (Al-Sharbini, 1933). Ibn Abidin explained that Waqf means to hold a property in accordance with the provisions of owner and used for the general benefit (Ibn Abidin, 1966). From the definitions of Waqf above, it can be concluded that the Waqf property in Islam must have seven specific features; namely the property to be devoted must be clear of its possession, it may be beneficial, not of the kind that is prohibited by the Islamic law, its permanent physical nature, cannot be used other than what is required, for the property of waqf which is not mentioned in use, it may be used in accordance with the requirements of Islamic law and revenue from waqf property may be used for general or specific benefits. Waqf is also an optional which is highly encouraged by Islam.

Pillars of Waqf are divided into four, namely; Waqf giver, Waqf property, Waqf recipient and offer and acceptance of Waqf (*sighah*) (Mustofa al-Khin, et al, 2003). The jurists have divided the Waqf into three main types, namely; in terms of acceptance, purpose and time. In terms of acceptance, Waqf can be divided into two; special Waqf and general Waqf (Wahbah al-Zuhayli, 2009). The special Waqf is an endowment that has clearly defined the recipients, whether to a particular individual, group or institution. This type of Waqf gives property ownership to the beneficiary, and only those who are entitled to manage, use and benefit from it. General Waqf is an endowment that does not define the recipients clearly, but refers to the welfare of the Ummah in general. This type of Waqf does not require the element of acceptance in Islamic law, but Allah is the owner of the property donated in this context. This Waqf is also managed by the Sultan or the government, while its

benefits are channeled to virtue in general. In terms of purpose, Waqf can be divided into three; namely Charitable Waqf, family Waqf and joint Waqf (Abu Zahrah, 1971). Charitable Waqf is performed because of Allah and the welfare of mankind. Family Waqf is an endowment dedicated to ourselves and family only. Meanwhile, the joint Waqf is associated with charitable Waqf and family Waqf. For example, Azman is a Waqf giver, donated his property for charity with a sum of RM 1,000.00 and the balance is given to his family members. In terms of time, Waqf is divided into two types; temporary Waqf and permanent Waqf (Abu Zahrah, 1971). Temporary Waqf is a restricted endowment, which is limited by time, such as for two years. After this period, it is no longer regarded as a Waqf property. Permanent Waqf is an endowment made eternally without time, which can be classified as a ceaseless charity (*Sadaqah jariah*) which will render rewards to the Waqf giver continuously until the donated property is destroyed or unusable.

In terms of ownership of Waqf property, the jurists are divided into two groups. The first group consisted of the Hanafi and Maliki jurists. They assumed that the Waqf property remained the property of the Waqf giver. According to them, Waqf equated with loans, rather than grants or gifts. Therefore, Waqf recipient only gains benefits. They also pointed out that the Waqf giver is the most qualified person to manage Waqf and management-related tasks should not be given to others. The views of the second group are different from the first group. The second group was pioneered by the Shafi'i and Hambali jurists. They stated that the property of Waqf is transferred to the Waqf recipient (beneficiary). According to them, the Waqf is the transfer of property from the Waqf giver to the beneficiary. This is equivalent to a gift or grant, in which the Waqf giver no longer has the power over the property that has been assigned to the beneficiary. However, all

the jurists agree that all the property Waqf cannot be sold, rewarded, given to others or inherited as long as it is still regarded as a Waqf property.

Based on the concept of Waqf in Islam, it is understood that the Waqf whether it is general or special, it actually belongs to Allah absolutely. Pursuant to this principle, Waqf property cannot be sold, bought, made as a gift or inheritance either by a Waqf giver or a Waqf recipient/beneficiary. Therefore, the use of this Waqf property is left to the beneficiaries and is managed in accordance with the requirements of Waqf giver.

#### *Implementation of Waqf in Malaysia*

Like zakat, Waqf is also included in the affairs of Islam under the jurisdiction of the state government. Provisions on Waqf are found in EPAIN and until 2018, only five states in Malaysia have the Special Enactment of Waqf, namely Selangor, Malacca, Negeri Sembilan, Perak and Terengganu. All provisions in EPAIN and the Special Enactment of Waqf clearly state that MAIN is the sole holder of all types of Waqf assets. This means that the other parties are not allowed to handle the management of the Waqf. Among the provisions that are associated with waqf are MAIN as the sole trustee of waqf property, the distribution of waqf property to the special waqf and general waqf, the benefit of the special waqf is to meet the special waqf purposes only, the benefits of general waqf can be used for purposes that do not conflict with Islamic law, all the property to be donated must be permanent, beneficial in accordance with Islamic law and irrevocable, the acquisition of property must be permanent, the purpose of waqf must be on the required matters, prohibition to endow more than 1/3 of the property owned and the records of the waqf property shall be kept by the MAIN (Baharuddin Sayin, Asmak Hj. Ali & S. Salahuddin Suyurno, 2006).

In managing Waqf, MAIN plays the role to manage all Waqf applications made by individuals or organizations covering special and general Waqf, recording and registering all types of Waqf properties, regulating all types of Waqf properties and developing Waqf properties, especially the Waqf properties categorized as general Waqf. In terms of practice, there are various forms of Waqf implemented in Malaysia such as property Waqf, cash Waqf, stock Waqf, feet Waqf, Takaful Waqf plan and so on.

#### *The concept of Baitulmal in Islam*

Baitulmal can be defined as a national treasury based on the history of Islamic rule (Ibn Taimiyyah, 1992). During the reign of the Prophet s.a.w, the role of baitulmal as an institution was less prominent. Among the factors that happens is because of Islam was still underdeveloped and not widely spread. The income and management of the country were also not complicated and complex. At this time, the country's source of income consists of the spoils of war or through a peace treaty. Zakat collection was then distributed to the asnaf. This situation continued until the reign of Caliph Abu Bakr Al-Siddiq r.a (Hailani Muji Tahir, 1988). In the 13th year of Hijrah, during the reign of Khalifah Umar Al-Khattab r.a, a department (*diwan*) named Baitulmal has been established to manage the state treasury. The treasury (Baitulmal) was established in Medina and in the territories under the rule of the government. The Central Government of Medina has placed several special officers in the territories under the jurisdiction of the Islamic government. All these officers were under the direction of the Central Government (Muhammad Sabri Haron, 2003). After the reign of the four Khalifah, the management of baitulmal became increasingly systematic. This is because the source of baitulmal property is increasing along with the increase of

territories under the Islamic government. Historically, baitulmal property has reached 900 million Dirhams during the Abbasid dynasty under the rule of the Caliph Harun al-Rasyid (Hailani Muji Tahir, 1988).

Baitulmal accepts certain sources, which are not limited to only Muslim societies, even including non-Muslims (Muhammad Kamal 'Atiyah, 1993). The sources of baitulmal consist of the collection of *kharaj*, *jizyah*, *fai'*, *ghanimah* and *'usyur*. *Kharaj* was a certain payment collected from crops cultivated by the disbelievers (*Musyrikin*). *Fai'* was a collection of crops from land given by disbelievers to Muslims as a result of the peace treaty. *Ghanimah* refers to war spoils obtained from the disbelievers. *Jizyah* is an individual tax imposed on non-Muslims. Meanwhile, *'usyur* was a 10% fee imposed on merchandise belonging to non-Muslims who came to do business in Islamic countries. For *ahl zimmah*, the goods tax charged was 5%. In addition to these sources, baitulmal also receives income from zakat collection, inheritance without heirs and property of unknown owners. However, the function and role of baitulmal have changed to be smaller and limited after the Crusades (1096-1258M) occurred, where the majority of Muslim countries were conquered by Western powers (Mustafa Daud, 1994). Based on the history of baitulmal, a formula can be made, namely the source of income for baitulmal is totally and infinite from the Muslim community, even covering payments from non-Muslims. This was in line with the broad scope and role of baitulmal as the state treasury.

The baitulmal concept can also be seen through the examples of Al-Mawardi, Abu Ya'la, Ibn Taimiyyah and Greg Zaidan. Al-Mawardi has divided public power in Islamic rule into various divisions, including finances and expenses. Among the financial resources were zakat, *fai'*, *ghanimah*, *jizyah* and *kharaj*.

Meanwhile, military and civil services were included in the aspect of expenses. In debating about baitulmal, he has elaborated baitulmal financial resources consisting of zakat, *fai'*, *ghanimah*, *jizyah*, *kharaj* and property of unknown owners. In the aspect of baitulmal expenses, Al-Mawardi asserted that baitulmal was obliged to spend its wealth for anything that benefits (*maslahah*) to the general Muslim community (Al-Mawardi, 1978). This view seems to coincide with the views of Abu Ya'la where he agreed with the views quoted by Al-Mawardi related to the resources and baitulmal expenses (Abu Ya'la al-Farra', 1983). In addition, Ibn Taimiyyah also talked about the concept of baitulmal in his writing entitled *Al-Siyasah al-Syar'iyah fi Islahi al-Ra'i wa al-Ra'iyah*. According to him, there are three types of property mentioned in the Qur'an and Sunnah as a public property, namely zakat, *ghanimah* and *fa'i* (Ibn Taimiyyah, 1983). Greg Zaidan classifies baitulmal as a group of government property that serves to collect all state property from various sources and spend it according to the interests of the Muslims (Greg Zaidan, t.t). Based on these views, it is clear that baitulmal is the national treasury according to the perspective of law and the administration of the Islamic country. The resources were like zakat, *fai'*, *ghanimah*, *jizyah*, *kharaj* and property of unknown owners. In terms of its sources and expenses, it is flexible and it can be spent on anything that leads to goodness towards the Muslim community in general.

#### *The implementation of Baitulmal in Malaysia*

Today, the existing Baitulmal is not the national treasury of the true concept. In the context of practice in Malaysia, it can be regarded as a unit or department in the administration of the State Islamic Religious Council (MAIN). Today, the existing Baitulmal is not the national treasury of the true concept. In the context

of practice in Malaysia, it can be regarded as a unit or department in the administration of the State Islamic Religious Council. Baitulmal is also not the treasury of the MAIN itself, but is categorized as the Special Fund of the Council. The council acts as a manager in managing baitulmal administration in a state. In terms of its source of income, baitulmal receives resources from unreasonable heritage property, Waqf properties, vows and goods found (*luqatah*), even zakat itself excluded because the fatwa in Malaysia has determined that the distribution of zakat and baitulmal cannot be united (Zakariah Abdul Rashid, 2003). Zakat is also not a baitulmal financial source because zakat is specifically spent on certain asnaf only, except where there is a surplus of zakat. Nonetheless, there are a variety of different fatwas regarding surplus of zakat among jurists, which some consider that this surplus can be put into treasury, some do not allow it and some of them categorize it as the dependent money (*tawaqquf*) (Mahmood Zuhdi Abdul Majid, 2009).

Each MAIN in Malaysia has provisions on the role of baitulmal in the State Islamic Administration Enactment (EPAIN) respectively. In general, baitulmal managers are responsible for managing baitulmal on the basis of trust. All types of assistance derived from baitulmal resources are intended to help and not intended to generate profit (Hailani Muji Tahir & Sanep Ahmad, 2009). The practice of baitulmal is different between the states in Malaysia such as the assistance for admission to the Institute of Higher Education, general assistance for *Muallaf*, assistance to be channeled to the Islamic Religious School, poor and needy livelihood assistance, assistance to further studies in the Middle East and so on.

## ANALYSIS AND DISCUSSION

In conclusion, there are three funds under the management of MAIN, namely Zakat, Waqf and Baitulmal. These three funds can be categorized as trust that must be managed by MAIN efficiently. This is in line with the concept of trust in accordance with the Islamic law and anything contained in the Federal Constitution, which provides MAIN as a trustee in matters or affairs related to the Islam, including Zakat, Waqf and Baitulmal.

Nevertheless, if reviewed the interpretation of the trust in detail, it is found that MAIN is the trustee of zakat and Waqf property, but for baitulmal property, it is fully owned by MAIN. In the context of baitulmal, MAIN acquired the source from one of the divisions of zakat asnaf, namely amil. Hence, MAIN has full power to manage and spend baitulmal property according to the Islamic law. Trust in the context of this baitulmal property is only in small circles when compared to the concept of trust in zakat and Waqf property. MAIN only needs to spend baitulmal property according to the benefit of Muslims as a whole. In accounting, this baitulmal property belongs to MAIN and is classified as a revenue.

This is in contrast to Zakat and Waqf, where the concept of trust is more binding on the role of the State Islamic Religious Council (MAIN). MAIN is responsible for spending zakat revenue, according to the division of seven asnaf as required by the Islamic law. Although the mandate allocated to MAIN in the distribution of zakat to seven asnaf is the same, but the interpretation of each of these asnaf groups varies according to the state, respectively. In accounting, zakat revenue is a trust on behalf of MAIN to be spent on the seven asnaf groups and classified as liabilities.

For Waqf, it is necessary to look at the types of Waqf. MAIN as the sole trustee of Waqf property is responsible for

managing all types of Waqf and this includes general Waqf and special Waqf. For special Waqf, MAIN is required to manage the Waqf according to the recipient as clearly stated by the Waqf giver. In special Waqf, the Waqf becomes the beneficiary's property and they are entitled to manage, use it and gain benefit. In accounting, this special wakaf is a trust on behalf of MAIN to be expended on the recipient and classified as a liability. Whereas, for general Waqf, it is more common for the welfare of the Muslim community because this type of waqf does not clearly identify the recipients. This type of waqf is not necessary to the element of acceptance, but it will continue to be Allah's property. This Waqf will be controlled by the government and its benefits will be channeled to virtue in general. In accounting, general Waqf is a trust on behalf of MAIN to be spent on charity and classified as revenue or equity. However, equity in the context of general Waqf is limited equity as it is still a trust that must be carried out by MAIN. In terms of ownership, there are no issues arising because of the Hanafi jurists still recognize imperfect ownership in Islam.

## CONCLUSION

In developing Islamic accounting standards for zakat, waqf and baitulmal in Malaysia, there are various accounting aspects to consider. This aspect includes the concept of revenue, expenses and liabilities that are applied must comply with the requirements of Islamic law. Implementation of Islamic accounting standards becomes more complex and focused on MAIN because of the legislative constraints inherent in the Federal Constitution, which it has to meet the requirements of all MAINs throughout Malaysia. The implementation of the Islamic accounting standards for zakat, waqf and baitulmal in Malaysia demonstrates the proactive efforts of the

Accountant General's Department of Malaysia (AGD) in reviewing and reviewing the requirements of Shariah-compliant accounting standards for Islamic institutions in Malaysia.

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## Strategy Model for Increasing the Potential of Zakat through the Crowdfunding-Zakat System to overcome Poverty in Indonesia

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### ABSTRACT

*In Indonesia, through Presidential Regulation No. 18 of 2007, Indonesia's annual economic development goals are directed to encourage economic growth in order to expand employment and reduce poverty. With implications for income equity, zakat has a strategic potential that is feasible to be developed into one of the instruments of income distribution in Indonesia. Based on data collection and distribution of funds of the Zakat Management Organization below, in 2015, the total fund collection experienced a growth of 10.62% compared to 2014. This study will discuss discussing the related Strategy Model for Increasing the Potential of Zakat through Crowdfunding-Zakat System for poverty alleviation in Indonesia. Abdullah (2015) in his research developed a new methodology to measure poverty alleviation in Pakistan, focusing on consumption / expenditure of poor households for basic needs, government expenditure in terms of zakat and the number of recipients of zakat as the three main determinants. In Syafiq (2014) the realization of the prospect of zakat in the modern economy must also be supported by the management of zakat management organizations in a modern way, meaning that in the fundraising strategy, and the distribution must follow modern management and strategy as a company in achieving its target. Thaker and Pitchay (2018) through their research revealed that crowdfunding model is used to raise funds to develop Waqf land in Malaysia where in their research they propose a sustainable model that can overcome liquidity problems faced by Waqf institutions in developing Waqf land. Using qualitative research methods with a literature study approach. With the crowdfunding-zakat system, it provides convenience in the collection of zakat funds from the wider community in line with several regions in Indonesia that show the potential and positive impact on income distribution.*

*Keywords: zakat, crowdfunding-zakat system, poverty.*

### INTRODUCTION

Poverty is still a fundamental problem faced by the Indonesian people (Azhar, et. al. : 2017, 16). The causes of poverty can be seen from several existing social conditions. Based on Kakwani in Ahmed, et. al. (2017) are seen as poor people not only in material seizures (measured by income or consumption) but also in different aspects of life such as

unemployment, poor health, lack of education, vulnerability, powerlessness or social exclusion. So that in Indonesia, through Presidential Regulation No. 18 of 2007, Indonesia's annual economic development goals are directed to encourage economic growth in order to expand employment and reduce poverty (Fathurrahman, 2012). Therefore, the government policy then accompanies the operational existence of the zakat

institution. The government passed laws to establish zakat institutions or give approval to organizations to manage the collection and distribution of zakat, it is very likely that Muslims see the law or agreement as a sign of legitimacy to operate (Mustafa, et. al., 2013). The implications for income distribution are where zakat is the main role. Zakat has strategic potential that is feasible to be developed as one of the instruments of income distribution in Indonesia (Thalib, et. al., 2017). Based on data collected and disbursed by the Zakat Management Organization below, the collection of zakat funds at the National level experienced a significant increase from 2010 to 2015.

**Table 1.** Growth of Zakat Fund Collection in 2010-2015 Nationally and in each Zakat Management Organization

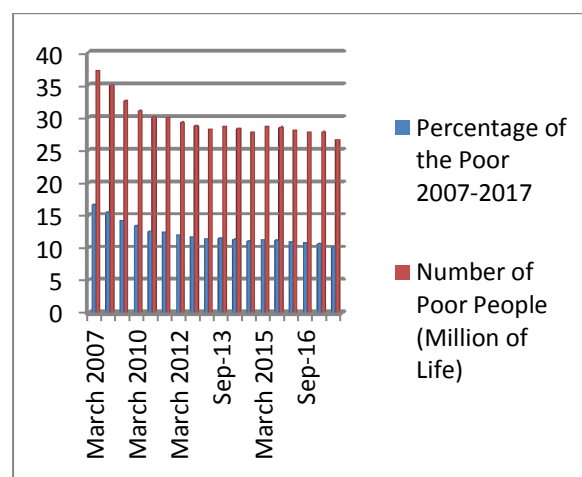
year	BAZNAS	BAZNAS in Province	BAZNAS in district/ City	LAZ	National	Growth
2010	33.125.920.074	306.512.258.082	525.608.580.693	634.917.482.126	1.500.164.240.975	
2011	40.403.967.865	204.482.157.749	824.014.964.426	659.963.269.358	1.728.864.359.398	15,25%
2012	50.212.435.875	253.252.821.346	1.179.716.104.080	729.217.590.043	2.212.398.951.344	27,97%
2013	59.238.304.066	1.645.482.867.203	281.687.974.612	653.194.923.848	2.639.604.069.729	19,31%
2014	82.293.545.780	415.451.020.092	1.422.364.285.476	1.379.891.148.652	3.300.000.000.000	25,02%
2015	94.068.893.820	642.797.514.841	885.309.169.850	2.028.193.434.453	3.650.369.012.964	10,62%

Source: BAZNAS (2017: 11).

With the allocation of zakat collection it also contributes to the empowerment of the poor. Based on Berita Resmi Statistik No. 05/01/Th. XXI, 2 Januari 2018, if we look at the last ten years, the number of poor people has gradually fluctuated. In 2007 to 2013, the poor population decreased from 16.58% in 2007, 15.42% in 2008, 14.15% in 2009, 13.33% in 2010, 12.49% in March 2011, 12.36% in September 2011, 11.96% in March 2012, 11.66% in September 2012, 11.36% in March 2013, and 11.46% in September 2013 of the total population. Whereas in 2014 towards 2017, the number of poor people experienced not too significant fluctuations, from 11.25% in March 2014, 10.96% in September 2014, 11.22% in

March 2015, 11.13% in September 2015, 10.86% in March 2016, 10.70% in September 2016, 10.64% in March 2017, and 10.12% in September 2017. The percentage results show that the government has so far played an active role in reducing poverty. This is a form of the implementation of government programs in line with the role of other funding sources that are used as poverty alleviation. Through providing employment and capital to them, in addition to poverty, people will have a source of income from their own productivity.

**Graph 1.** Number of Poor People



Source: Berita Resmi Statistik No. 05/01/Th. XXI, 2 Januari 2018 has been processed.

This increase is in line with the increase in the number of people and residents who are obliged to pay tithe (sophisticated, et. al., 2017). Given the growth in zakat collection, at present the community is faced with the need for efficiency in channeling the zakat. Along with the rapid development of technology, the matter of giving zakat can now also be done through the internet. The alternative funding is known as crowdfunding. Crowdfunding is a funding scheme that collects funds from internet-based crowd (Arifin and Wisudanto, 2017). Based on research from Thaker and Pitchay (2018) Crowdfunding model is used to raise funds to develop Waqf land in Malaysia where in their research they propose a sustainable

model that can overcome liquidity problems faced by Waqf institutions in developing Waqf land. In Indonesia, there are four official zakat distribution sites in the country including Dompot Dhuafa, Rumah Zakat, National Zakat Agency/ Badan Amil Zakat Nasional (BAZNAS), and Kitabisa.com. Based on the discussion above, this research will discuss discussing the Strategy for Increasing the Potential of Zakat through the Crowdfunding-Zakat System in alleviating poverty in Indonesia.

## LITERATURE REVIEW

### *The purpose of Zakat*

Zakat is one of the pillars of Islam which has a social dimension. That is, the implementation of zakat is not just to abort the obligation as a Muslim, but it is hoped that it will be able to contribute solutions to social problems, especially poverty (Tim Divisi Kepatuhan dan Kajian Dampak LAZ al-Azhar, 2017: 4). In the concept of Islam, zakat is one of the state's revenues. Therefore, the acquisition of zakat is very important for the survival of the life of the state to achieve common goals, prosperity (Azhar, 2017: 91). Zakat is one of the pillars of Islam with a dimension of social justice (Andriyanto, 2014). The essence of zakat is the management of funds taken from *aghniyā* '(Surah al-Taubah [9]: 103) to be submitted to those who are entitled to receive it (Surah al-Taubah [9]: 60) and aims to prosper the social life of Muslims (Surat al-Dzariyat [51]: 19).

To run the wheels of government, it must be based on the values of equality of justice which includes economic activities and distribution. The principle of economic distribution that becomes a guideline in the Islamic economic system is to increase production (output), and distribution of wealth so that the circulation of wealth increases and allows bringing fair distribution among various components of society, and does not focus capital on a

small portion of certain groups (Hidayat, 2017) . In the Islamic macroeconomic model with an expenditure approach, the domestic economy does not only consist of three sectors, namely individuals, business and government but there is also a social sector. This sector includes social institutions in the community, including foundations, *amil zakat*, orphanages, non-governmental organizations and so on (K. Amiruddin, 2015).

Therefore zakat management organizations are required not only to be trustworthy and professional zakat managers, but also to be able to bring benefit in the midst of the people through comprehensive and real zakat empowerment programs providing solutions for the welfare of the community and overcoming poverty (Tim Divisi Kepatuhan dan Kajian Dampak LAZ al-Azhar, 2017: 4): This is confirmed in Law No. 23 of 2011 concerning Zakat Management Article 3, namely: Zakat Management aims to improve the effectiveness and efficiency of services in the management of zakat; and increasing the benefits of zakat to realize community welfare and poverty alleviation.

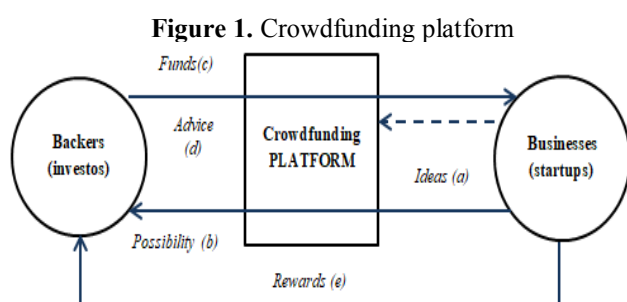
Various instruments that can be used as sources of state financing are basically *muamalah* aspects, in this case not including zakat (P3EI, 2014: 511). Qaradhawi's view is included in what can be called an "orthodox" school that treats zakat as a form of devotional law (worship). Therefore, the form and details of the rules must remain intact as revealed. However, contemporary Islamic economists, like, Khan argues that zakat should be classified as transactional law and not a law of piety (Obaidullah, 2016). In Islamic public finance, zakat is one of the financial instruments used for public spending as part of the source of government opinion issued to meet the needs of the intertwined people included in the 8 *mustahiq* groups (Jaelani, 2015). This characteristic makes zakat inherently has several properties including:

- a. Pro-poor and self-integrated.

- b. Zakat has clear provisions with a certain measure of expenditure and time that cannot be changed by anyone.
- c. Zakat has different terms of expenditure for different types of property.
- d. Zakat has a broad target base for all economic activities.
- e. Zakat is a spiritual tax that must be issued by the Muslim community under any conditions (Azhar, 2017: 19).

### Crowdfunding-Model

Given the growth in zakat collection, at present the community is faced with the need for efficiency in channeling the zakat. Along with the rapid development of technology, the matter of giving zakat can now also be done through the internet. The alternative funding is known as crowdfunding. Valanciene & Jegeleviciute (2014) define crowdfunding as a method for connecting between entrepreneurs who want an increase in capital and new investors who have capital resources and want to invest in small amounts through internet-based intermediary entities. Lambert and Schwienbacher in Thaker and Anwar (2018) have defined crowdfunding as "open calls, basically through the internet, to provide financial resources in the form of donations or in exchange for some form of rewards and / or voting rights to support initiatives for specific purposes".



Source: Valancienien & Jegeleviciute, 2014.

There are three main parties who become stakeholders, namely entrepreneurs, crowdfunding platforms,

and investors (backers). The main stakeholders have their respective roles and interests. The first path starts from entrepreneurs (business or startups) submitting ideas, funding requests through crowdfunding platforms and promising returns to investors. Backers (investors) will look at the investment opportunities offered by entrepreneurs and give their commitment to funding or giving advice. The crowdfunding platform acts as an intermediary institution that brings together investors and backers (Valanciene & Jegeleviciute, 2014). The legal basis of crowdfunding is helping each other in kindness / takaful and free of usury. So far, what is funded in crowdfunding is a social project, such as raising the economy of small communities and solving poverty. This has been explained in paragraph Q.S. al-Maidah: 2 which reads:

شَدِيدُ اللَّهِ إِنَّ اللَّهَ وَاتَّقُوا وَالْعُدْوَانَ الْإِثْمِ عَلَى تَعَاوَنُوا وَلَا الْعِقَابِ

Meaning:

"And do not help in committing sins and transgressions. And fear Allah, for verily Allah is severe in His punishment." (Surat al-Maidah: 2).

Crowdfunding can be divided into four categories: crowdfunding donations, crowdfunding prizes, crowdfunding loans, and equity crowdfunding. Including the following:

#### a. Crowdfunding Donations

Crowdfunding donations / donations are places where funds are collected for social, artistic, philanthropic or other purposes, and not as a reward for something of real value. It does not provide material returns (Massolution in Thaker and Anwar, 2018). For example, in the US, Kickstarter, Indiegogo and others are one platform that supports crowdfunding-based donations. In Indonesia, there are several crowdfunding platforms including Dompot Dhuafa, Rumah

Zakat, National Zakat Agency (BAZNAS), and Kitabisa.com.

b. *Crowdfunding Rewards*

Crowdfunding reward is a collection of funds, where investors or donors receive some real prizes (such as membership gift schemes, products, coupons and others) as appreciation tokens. This award can be in various forms and not in the form of money (cash) (Massolution in Thaker and Anwar, 2018). For example Kickstarter, RocketHub, Indiegogo and others.

c. *Lend Crowdfunding*

Lending crowdfunding is an online platform that matches lenders or investors with borrowers or issuers to provide loans at low interest rates set by the platform (Massolution in Thaker and Anwar, 2018). There are several platforms regulating loans between individuals, while other platforms raise funds and then lend to small and medium enterprises. Some prominent examples from the US are Lending Club, Prosper, and others. and from England is Zopa, Funding Circle, etc. Some platforms charge fees based on loans.

d. *Equity-based Crowdfunding*

Equity-based crowdfunding refers to funds collected through online by a business, especially early-stage funding, by offering investors equity interests in business (Massolution in Thaker and Anwar, 2018). Businesses seeking to raise capital through this mode usually advertise online through crowdfunding platform websites, which function as intermediaries between investors and start-up companies (Massolution in Thaker and Anwar, 2018). In the UK two platforms, Crowdcube and Seedrs, have dominated the narrative for crowdfunding investment in terms of equity.

Some of the previous studies that became the reference in this study were according to According to Fathurrahman (2012), poverty is not only related to cultural problems, but also structural problems concerning how the state makes fiscal policies oriented to poverty alleviation culturally, Islam advocates the role of every individuals in improving their quality of life and fostering a process of social togetherness through zakat, infaq, and sadaqah. In Jalles (2017), fiscal adjustments are explained, according to their nature, affecting income inequality. Hidayat (2017) revealed that one of the impacts of income inequality is the increasing capital of capital owners. The owner of the capital becomes even richer because of the profits earned, while the worker only has the capital of his labor and expertise.

In K. Amiruddin (2015) explained that the concept of zakat in Islam is the elements contained in fiscal policy. Abdullah (2015) in his research developed a new methodology to measure poverty alleviation in Pakistan, focusing on consumption / expenditure of poor households for basic needs, government expenditure in terms of zakat and the number of recipients of zakat as the three main determinants. In Syafiq (2014) the realization of the prospect of zakat in the modern economy must also be supported by the management of zakat management organizations in a modern way, meaning that in the fundraising strategy, and the distribution must follow modern management and strategy as a company in achieving its target. Thaker and Pitchay (2018) through their research revealed that crowdfunding model is used to raise funds to develop Waqf land in Malaysia where in their research they propose a sustainable model that can overcome liquidity problems faced by *Waqf* institutions in developing *Waqf* land.

## RESEARCH METHODOLOGY

### *Types of research*

The type of research in this study is qualitative with a literature study approach with data sources namely secondary data obtained from previous studies, and other reference sources. Literature study is the method used to collect data or sources related to the topics raised in a study obtained from various sources, journals, documentation books, internet and literature. This study tries to explain the role of zakat-system crowdfunding in zakat collection through information sources related to several programs carried out by the National Zakat Agency/ Badan Amil Zakat Nasional (BAZNAS) to improve the distribution of income in several regions in Indonesia as a case study in this study. Excavated case studies are single entities or phenomena from a particular period and activity (can be in the form of programs, events, processes, institutions or social groups), as well as collecting detailed information using various data collection procedures as long as the case occurs (Abdullah and Saebani, 2014: 71). Some of these areas include:

1. National Zakat Agency/ Badan Amil Zakat Nasional (Baznas) Cirebon City.
2. National Zakat Agency/ Badan Amil Zakat Nasional (BAZNAS) Abid Takalamingan, North Sulawesi Province (North Sulawesi).
3. National Zakat Agency/ Badan Amil Zakat Nasional (Baznas) in the Alif farmer group, Bringinsari Village, Kendal, Central Java.
4. National Zakat Agency/ Badan Amil Zakat Nasional (Baznas) of Probolinggo Regency.

### *Data Type*

The type of data in this study uses secondary data. Secondary data is a data

source that does not directly provide data to data collectors (Sugiyono, 2008: 402). This secondary data is data that is supporting the needs of primary data such as books, previous studies and various reading sources related to the Strategy Model for Increasing Zakat Potential through the Crowdfunding-Zakat System to overcome Poverty Alleviation in Indonesia.

### *Method of collecting data*

Data collection methods used in this study use the theory triangulation technique. Data or information from one party is checked for truth by obtaining information from other sources (Abdullah and Saebani, 2014: 73). The goal is to compare information about the same things obtained from various references and literature so that there is a guarantee of the level of trust.

The benefits of triangulation theory is to increase research trust, create innovative ways of understanding phenomena, uncover unique findings, challenge or integrate theories and provide a clearer understanding of the problem. The use of various theories can help provide a better understanding when understanding the data sourced from the literature as well as the available references to serve as a reference in providing a description of the Model for Increasing the Potential of Zakat through the Crowdfunding-Zakat System to overcome Poverty Alleviation in Indonesia, based on several stages include:

1. Finding and registering all variables that need to be examined which are sourced from information containing statistical data, articles, and previous research that can be used as a reference in the discussion related to the Strategy Model for Increasing Zakat Potential through the Crowdfunding-Zakat System to overcome Poverty Alleviation in Indonesia ,
2. After the relevant information is found, the researcher then reviews and compiles library material in

accordance with the order of importance and its relevance to the problem being studied,

3. The information material obtained is then read, recorded, arranged and rewritten,
4. Finally the process of writing research from the materials that have been collected is put together in a research concept.

## RESULTS AND DISCUSSION

### *The Role of Zakat in Poverty Alleviation in Indonesia*

In fact, the current global economic development has implications for the welfare of the country (Jaelani, 2016). Since the global financial crisis and fiscal austerity needs in many countries to deal with long-term public finances have caused sustainability concerns, the task for policymakers has been made more difficult (Jalles, 2017). Previously, Mishra (2000) stated that globalization had limited the capacity of nation-states in carrying out social protection. As a result of these implications, the limits and strength of nation-states are increasingly fading, dispersing to localities, independent organizations, civil society, supra-national bodies (such as NAFTA or the European Union), and multinational companies. In facing the ASEAN Economics Community (AEC), the economic activities carried out could not pay attention to ethical issues that could lead to fellow economic actors colliding their interests, so that this condition could create forces that could destroy other economic actors (Jaelani, 2016).

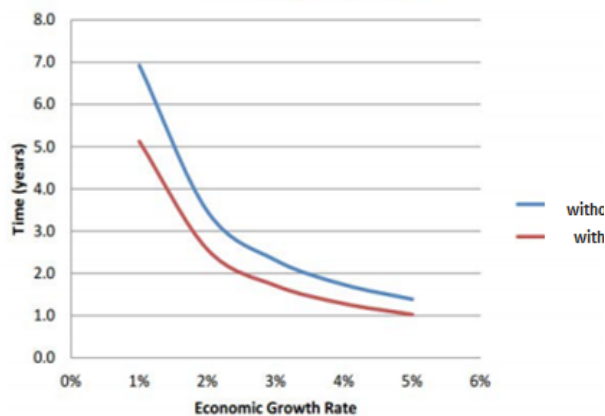
Fiscal policy is the only tool that must be addressed by policy makers to achieve a breakthrough to dampen fluctuations in the business cycle and reduce the volatility of output at the national level (Tzivinikos, 2017). Therefore, the government has a role to

maintain the level of accessibility remains by using zakat regulation and other tools in the public sector (Darsono, et. al., 2017: 38). This must be utilized in order to realize the potential of zakat, which is as high as 3.40 percent of GDP. In his research, Abdullah (2015) gave suggestions related to zakat allocation policies. First, because zakat has proven to be a very effective way to help people from severe poverty (Q1), the collection and distribution of zakat must be increased. Second, because the amount of alms received by the poor medium (Q2), especially those living in rural areas, far below the amount needed for them to live worthy, then budget funds to increase the allocated amount should be increased on the agenda of the central government. Third, the old method of distributing zakat based on the provincial to national population ratio must be removed. Prediction of potential zakat BAZNAS more after the establishment which was inaugurated by the President in 2001 where BAZNAS coordinate a national fundraising charity, and there are instruments used to predict the zakat in Indonesia include: (1) The number of the Muslims; (2) Number of prosperous Muslim families; (3) Gross Domestic Product; (4) Direct surveys of the expenditure of zakat, infaq, alms of the Muslims (Azhar, et. al., 2017: 93). This will provide support for Presidential Regulation No. 18 of 2007, where Indonesia's annual economic development goals are directed at promoting economic growth in order to expand employment and reduce poverty (Fathurrahman, 2012). In addition, it can also provide support to the Ministry of Finance of the Republic of Indonesia Directorate General of Budget 2012, the target of which is to increase income evenly and provide wider access for the people to get education, health, clean water, and other basic needs.

Specifically the zakat sector facilitates the lower classes of society to be able to actively access the economy. According to Mintarti, et. al. (2012) have observed the time needed to get out of

poverty. Without the distribution of zakat, the time needed to release the poor from the poverty line is around 7 years. Whereas the distribution of zakat is proven to shorten the time needed from 7 years to 5.1 years.

**Graph 2.** Estimated Time for Poverty Poverty Due to Zakat



Source: Mintarti, et. al. (2012).

If you look at the role of zakat on poverty above, the strategic role of zakat for the community is as follows (Andriyanto, 2014):

#### 1. *Capital*

According to research conducted by PIRAC (Public Interest Research and Advocacy) that the potential for zakat in Indonesia ranges from 19-20 trillion per year, a sufficient capital for community development, and that number will be even greater as the Muslim awareness of zakat and fiqh ability to describe new types of business / income that are included as zakat objects.

#### 2. *Social Justice*

The implementation of zakat raises social justice in the midst of society, in addition to the emergence of sources of zakat receipts from new types of income as well as zakat is empowered for the needs of the poor who are fulfilled by the rich in their midst.

#### 3. *Social Equilibrium*

The social balance that is built by zakat makes the people get their share obtained from the wealth of the rich people around them, so that the social gap is not high.

#### 4. *Social Guarantee*

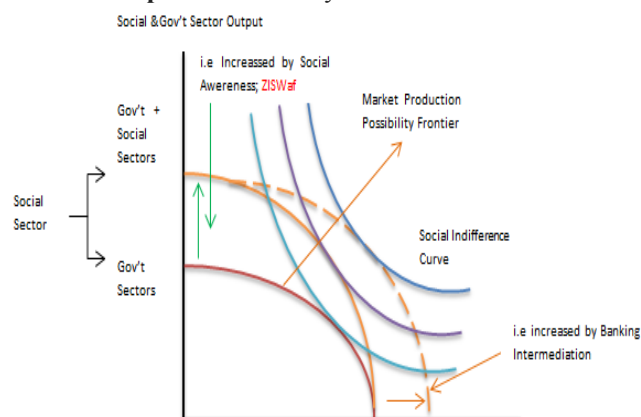
The community feels guaranteed when zakat can be realized in its form, so that the poor need not worry about seeking treatment or getting education services because there is no guarantee.

#### 5. *Social Safety*

With the accumulation of large zakat funds as well as development capital, it is also useful for standby funds that are ready to be used at any time, especially against unexpected events of natural disasters, fires, floods and others.

The presence of the social financial sector complements the existing financial sector and has a major impact on social satisfaction. The combination of two main sectors in the economy, namely the public and private sectors form the market production possibility frontier and produce the same level of satisfaction for the community at any point in both combinations (Darsono, et. al., 2017: 42). In this case, zakat (other than infaq, alms and endowments) is one of the social finance sectors that can increase the market production possibility frontier.

**Graph 3.** Community Satisfaction Curve



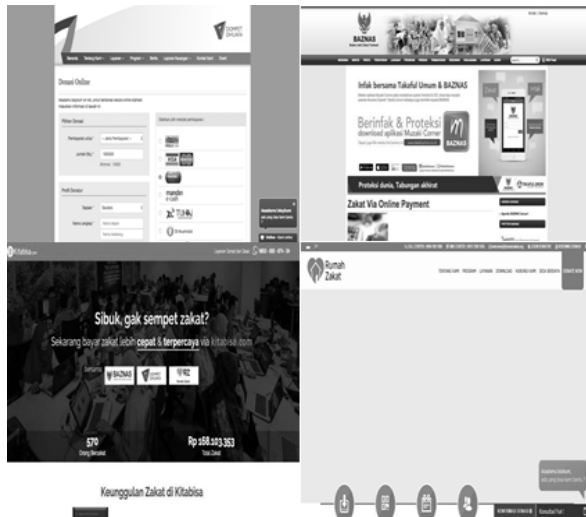
Source: Darsono, et. al. (2017: 42).

Actually, the government has had several programs to alleviate poverty in productive communities. According to Fathurrahman (2012), one of the government's concrete steps in overcoming poverty is *Program Nasional Pemberdayaan Masyarakat Mandiri* (PNPM-MANDIRI). In addition, the government also carried out the Micro and Small Business Empowerment program and climate improvement by providing *Kredit Usaha Rakyat* (KUR). However, it is unfortunate that the capital sector held by the banking and capital market industries does not fully touch the micro sector, which mostly provides fulfillment to the needs of the community. Besides, another impact is that large-scale imports also lead to a cessation of productivity in the micro sector. Suryani (as Chairman of the DPP HIPPI) said the productive small and medium sized micro business government could employ more than 107.6 million Indonesians and contribute 60.6 percent to Indonesia's GDP. He added, the strength of MSMEs in building the Indonesian economy due to its excellence in several factors namely specific focus ability, national flexibility, low cost, and speed of innovation (Nurfadilah, *UMKM Mampu Dongkrak Pertumbuhan Ekonomi*, kompas.com, 10 July 2018). With the help of capital for the businesses they run, they will feel very helped (Azhar, et. al., 2017: 88). Zakat can be an alignment of existing government programs, especially to raise the potential of the poor who lack capital to be able to become entrepreneurs. Efforts to distribute income to alleviate poverty are to provide opportunities for poor productive families and communities to deal with their problems independently, which means that the government must restructure their roles, from their role as empowerment agents to empowerment facilitators. Thus the community with its micro business can help accelerate economic growth in Indonesia.

### *Strategy Model for Increasing Zakat Potential through the Crowdfunding-Zakat System*

To achieve goals and minimize obstacles, the zakat management organization must use modern methods as a company (Syafiq, 2014). According to Andriyanto (2014) Public awareness and confidence in paying zakat through amil institutions has increased over time. The problem that is still behind the background is the distribution of zakat allocations that have not prioritized the smallest scope because of the limited access to information from the local area and the mobilization that results in the impediment of affordability. In addition, the limited access to zakat distribution is also due to the affordability of donors (*muzakki*) in channeling to the zakat collectors. If you look at the potential of technological development that exists today, fundraising is initially carried out more directly, between beneficiaries or institutions with donors, now it can also be done indirectly or online through the internet. In Thaker and Anwar (2018) Over the past five years, it seems the crowdfunding platform (CFP) has achieved extraordinary growth. There are a total of 1250 CFPs worldwide. Some official zakat suppliers in the country have added the option to pay tithes online, including the ones below. Crowdfunding platform survey conducted by Wisudanto & Arifin (2017) found that there were 6 crowdfunding platforms with considerable capitalization. Total funds collected from these platforms reached more than 505 billion rupiah. Total users of both investors and accessors reached 339,581 entities.

**Figure 2.** Several Zakat Crowdfunding Sites in Indonesia



Source: Dompetchuafa.com, puskasbaznas.com, kitabisa.com, rumahzakat.com downloaded May 23, 2018 has been processed.

Crowdfunding does not only contain external social capital but also internal social capital which both play an important role in the successful collection of funding (Arifin and Wisudanto, 2017). In Colombo et. al. (2014) crowdfunding is referred to as a loci or memory center for social relations. Citing data from a BAZNAS survey, Fuad Nasar, the Director of the Ministry of Religion's Zakat and Waqf Empowerment, said that the potential for zakat for individual wealth and income in Indonesia actually reaches Rp. 138 trillion per year. If the collection is realized in accordance with the target of 10 percent of the potential, then the next three years are projected that national zakat revenue will reach the target of Rp. 13.8 trillion per year (Agus Yulianto, *Pengumpulan Zakat 2017 Naik 20 Persen*, republika.co.id, January 2, 2018) With the implementation of crowdfunding zakat, zakat collecting and channeling agencies also showed their development in zakat collection and have provided several programs to improve income distribution in several regions in Indonesia which show the potential and positive impact in income distribution, including:

- a. The National Zakat Amil Agency (Baznas) of Cirebon City targets the collection of zakat this year to reach Rp. 5 billion. Even though it increased compared to last year, the actual potential of zakat is even greater. The Head of Baznas Cirebon City, Dwi Budi Novianto revealed during the Seminar on Inheritance of Capital Loans and Baznas Scholarships in Cirebon City, Tuesday (20/2), the potential of zakat in the City of Cirebon is actually very large. He estimates, the figure is in the range of Rp. 10 billion (Lilis Sri Handayani/ Hazliansyah, *Baznas Kota Cirebon Targetkan Pengumpulan Zakat Rp 5 Miliar*, republika.co.id, February 20, 2018).
- b. Chairman of the National Zakat Agency (BAZNAS) Abid Takalamingan said in North Sulawesi Province (Sulut) it was estimated that the potential for zakat could reach Rp. 60 billion in a year (Ani Nursalikah, *Potensi Zakat Sulut Rp 60 Miliar*, republika.co.id, March 29 2018).
- c. The National Zakat Agency (Baznas) is running a farm development program to villages where the community has the potential to be fostered as farmers. The program has been running for about a year and received a pretty good response. One of the results of the assistance of Baznas is the Alif farmer group, Bringinsari Village, Kendal, Central Java. Chairman of the Alif farmer group, Bukhor said, when Baznas came to provide assistance and guidance, the conditions of the local community were included in the criteria for pre-prosperity (Rahmat Fajar/ Agus Yulianto, *Program Pemberdayaan Peternak Baznas Direspons Warga*, republika.co.id, August 17, 2017).
- d. The National Zakat Agency (Baznas) of Probolinggo Regency is rolling out a community economic empowerment program. No half-hearted, the budget prepared for 5 (five) districts reaches

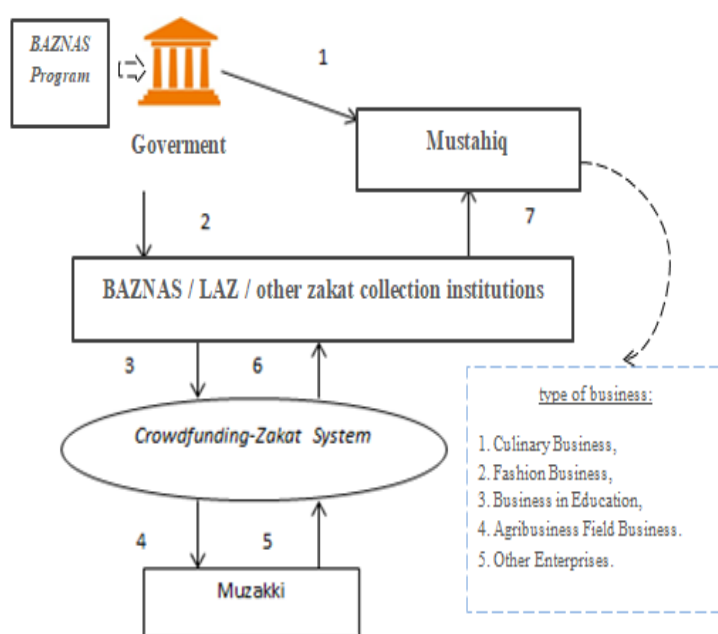
Rp. 100 million. Where each sub-district gets an allocation of Rp. 20 million. The five regions were chosen because the poverty rate is quite high and in remote areas. Especially in Pakuniran Subdistrict, because there has already been a Zakat Management Unit (UPZ) that handles agricultural zakat and zakat mal. According to Muzammil, the community's economic empowerment program aims to help at least 1 person who cannot afford it. The hope is that this program will run in a rolling manner so that the benefits can be felt by all disadvantaged communities (Syamsul Akbar, *Baznas Gulirkan Program Pemberdayaan Ekonomi Umat*, www.probolinggokab.go.id, May 26, 2017).

In the distribution of zakat through the system of mutual funds, the system can have a positive impact on the acceleration in increasing the income distribution of the poor. This helps to achieve efficient allocation of resources in the economy (Thaker and Anwar, 2018). Based on modern management as intended in Law Number 38 of 1999 concerning the management of zakat, which was then amended by Law No. 23 of 2011 concerning the Management of Zakat, is intended so that zakat is able to make a real contribution to improving the welfare of the people. Syafiq (2014) explains, in fundraising strategies, and the distribution must follow modern management and strategy as a company in achieving its target.

Therefore, there is a need for cooperation between the government and zakat management so that income distribution continues to develop. As the government functions as a fiscal policy as an instrument in realizing economic objectives, namely as an income policy. In Islam fiscal policy adheres to the steps taken by the Prophet Muhammad SAW, especially in increasing rational income and

the level of work participation. The Messenger of Allah carried out the policy of airing the Muhajirin and Ansar which caused the distribution of income from the Ansar to Muhajirin which had implications for the increase in total demand in Medina (Yuniarti, 2016: 225). The zakat management model intended is as follows.

**Figure 3.** Zakat Management Model through the Crowdfunding-Zakat System Model



From the above model (figure 3), crowdfunding is intended as a donation collection system (crowdfunding donations). The crowdfunding platform acts as an intermediary institution that brings together investors and backers (Valanciene & Jegeleviciute, 2014). In step 1, the Government is tasked with monitoring to see the level of welfare of local communities in order to survey the economic conditions in the area. Step 2, BAZNAS/ LAZ/ other zakat collecting institutions based on the provisions and information from the order to verify the community (mustahiq) who need financial assistance for development or are looking to start their business. step 3, BAZNAS/ LAZ/ other zakat collecting institutions through the crowdfunding-zakat platform provides services for collecting zakat on the muzakki. Step 4 picks up the muzakki who

want to donate their zakat funds through advertising on the crowdfunding-zakat platform. Step 5, Collect funds from muzakki who want to distribute zakat by the manager. Step 6, the zakat donations received are directed to BAZNAS/ LAZ/ other zakat collecting institutions that manage the zakat-crowdfunding site. On step 7, BAZNAS/ LAZ/ other zakat collecting institutions that have the authority to allocate zakat to *mustahiq* who have fulfilled verification in the implementation of BAZNAS programs.

This will facilitate the *mustahiq* to develop their potential and fulfill the need for venture capital through these income distribution programs. Social capital refers to the collective value of all social networks and trends arising from these networks to norms of reciprocity (al-Faizin and Akbar, 2018: 191). The Crowdfunding-zakat system can provide benefits in bridging donors with people who need more efficient funds in the collection of zakat will increase.

## CONCLUSION

Over the past five years, it seems the crowdfunding platform (CFP) has achieved extraordinary growth. There are a total of 1250 CFPs worldwide. In the distribution of zakat through the system of mutual funds, the system can have a positive impact on the acceleration in increasing the income distribution of the poor. Fuad Nasar, the Director of the Ministry of Religion's Zakat and Waqf Empowerment, said that the potential for zakat for individual wealth and income in Indonesia actually reaches Rp. 138 trillion per year. The Crowdfunding-Zakat system provides convenience in the collection of zakat funds from the wider community in line with several regions in Indonesia which show the potential and positive impact in income distribution, including:

- a. The National Zakat Amil Agency/ Badan Amil Zakat Nasional (Baznas) of Cirebon City targets the collection of zakat this year to reach Rp. 5 billion.
- b. Chairman of the National Zakat Agency/ Badan Amil Zakat Nasional (BAZNAS) Abid Takalamingan said in North Sulawesi Province (Sulut) it was estimated that the potential for zakat could reach Rp. 60 billion a year.
- c. Baznas look for villages whose communities have the potential to be fostered as farmers. One of the results of the assistance of Baznas is the Alif farmer group, Bringinsari Village, Kendal, Central Java.
- d. The National Zakat Agency/ Badan Amil Zakat Nasional (Baznas) of Probolinggo Regency is rolling out a community economic empowerment program. The budget prepared for 5 (five) districts reaches Rp. 100 million. Where each sub-district gets an allocation of Rp. 20 million.

The potential of zakat collection which has implications for its allocation, also needs support from other factors, including understanding the people who are obliged to pay zakat (*Muzakki*) must also be increased, because it has a link in influencing the amount of zakat funds collected by zakat institutions. In addition, education needs to be given to the public regarding the obligation to pay zakat, so that the program of income distribution and poverty alleviation through the potential of zakat can continue to be carried out. And, in order for the poverty alleviation program through crowdfunding-zakat system to be implemented properly, and empowerment of the productive community can be carried out, assistance can be made so that it can be directed and maintained its sustainability level, especially for capital assistance programs through the supervision team from BAZNAS. In addition, there is monitoring that is responsible for the program, so that business development can be monitored optimally.

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## Capitalizing on Economic Function of the Institution of *Zakāt* in Modern Economy

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### ABSTRACT

*This study analyzes the economic potential of the institution of Zakāt on income redistribution, poverty and aggregate demand. Through a mathematical exposition, we show that if a person keeps idle investible wealth, then Zakāt will deplete the idle wealth over time. On the macroeconomic front, proportional Zakāt linked with income will act as an automatic stabilizer. If an economy is in disequilibrium and policies fail to immediately recover and boost incomes, wealth Zakāt will enable the distributive allocation that works independently of the business cycles and will help in stabilizing the extremes of the business cycles. In this way, wealth Zakāt will act as a permanent stabilizer. We discuss that Zakāt is an important tool for redistributing income and it can also increase aggregate spending. The redistribution from people with lower MPC to people with higher MPC will boost aggregate spending even with the same level of aggregate income. Finally, we recommend certain steps at the policy and implementation level so that the institution of Zakāt can be effectively utilized to contribute in poverty alleviation. We recommend that it is appropriate to disburse Zakāt at the federal level. This way, the regional disparities can be reduced more effectively. To gain the trust and the confidence of people, it is vital to improve the governance and transparency. In this regard, we recommend that the Zakāt collection and disbursement details shall be reported in a standard way periodically. We also highlight the importance of creating synergies between Zakāt and other welfare programs. We also draw attention towards modifying the accounting standards to achieve transparent computation, assessment and collection.*

### INTRODUCTION TO ZAKĀT

*Zakāt* is an important institution in an Islamic economic framework for poverty alleviation and economic welfare. In Islam, *Zakāt* is a religious obligation to pay a part of wealth and production to the government (Chapter Tauba: Verse 103). As per Islamic injunctions, the government has to spend the *Zakāt* funds on specified heads for public welfare (Chapter Tauba: Verse 60).

In its economic character, *Zakāt* is a combination of a net worth levy and a production levy. The institution of *Zakāt* comprises a net worth tax of 2.5% on all bases of wealth except for the wealth below *Nisāb* and the assets in regular

personal use like home, personal transport and furniture (Haneef & Mahmud, 2011). According to the mainstream Islamic jurisprudence, wealth subject to *Zakāt* would include:

- ❖ Metals identified in *Hadith* (Gold & Silver) and used as currency.
- ❖ Livestock.
- ❖ Tradable inventory.
- ❖ Currency note and coins (legal tender).
- ❖ Financial securities convertible in currency
  - Investment in stocks.
  - Investment in bonds.
  - Investment and money held in bank deposits.
  - Investments in mutual funds etc.

The derivation for production tax comes from the fact that the produce from rain-fed lands was subject to a 10% production value tax whereas, the produce from irrigated lands (which had to be provided with capital in the form of water supply) was subject to a 5% production value tax in the Prophet's (PBUH) time.

If we look at the institution of *Zakāt*, we find that the payer of *Zakāt* and the receiver of *Zakāt* belong to two different income classes. The payer of *Zakāt* is non-poor with surplus wealth above *Nisāb*. On the other hand, the receiver of *Zakāt* is usually a poor person with no surplus wealth above *Nisāb*. Thus, the threshold wealth of *Nisāb* makes a distinction between the payer and receiver and helps to achieve targeted income and wealth transfer to the people who are usually the poor people. Since this redistribution is based on wealth rather than income, it can achieve the redistribution objectives more effectively and consistently since wealth fluctuates much less than income over the business cycles.

Oxfam (2017) reports that 8 individual persons have as much wealth as bottom 50% of the entire global population. Their combined wealth is \$426.2 billion as of end-2016. As per World Bank, there are 767 million people below the poverty line of \$1.90/day. It means that poverty gap is \$531.9 billion ( $1.90 \times 767,000,000 \times 365$ ) per year. Comparing the wealth owned by only the richest 8 persons (\$426.2 billion) and the total global poverty gap funding requirement (\$531.9 billion), one can see how redistribution of wealth can help in pooling poverty alleviation funds. Oxfam (2017) reports that global wealth has reached \$255 trillion. It is enough to give \$1 a day to 767 million poor people for 910 years. A single year 2.5% *Zakāt* on it will give \$1 a day to 767 million poor for 23 years.

According to the Food and

Agricultural Organization (FAO), there are approximately 800 million people who suffer from hunger and are food insecure in their routine lives. Most of the poor countries lack basic resources to kick-start growth and to invest in health and education. Thus, the redistribution of resources is vital to enhance income as well as the capacity to earn sustainable incomes, which requires income support programs, basic health and education as well as microfinance to build small enterprises.

According to The Hunger Project, 2.4 billion people do not have adequate sanitation and each day, nearly 1,000 children die due to preventable water and sanitation-related diarrheal diseases. It is partly because sanitation is not good business as compared to cellular services and life's other comforts and luxuries. Interestingly, according to the Food and Agricultural Organization (2013), for the world as a whole, per capita food supply rose from about 2,200 kcal a day in the early 1960s to more than 2,800 kcal a day by 2009. The institution of *Zakāt* could help in providing income support to poor people who are food insecure due to lower and unsustainable incomes.

Nearly 50 percent of the people living in extreme poverty are 18 years old or younger. This goes on to show that a significant portion of our global population would not have a fair start to achieve socio-economic mobility. Thus, proper nourishment, basic medicines and vaccinations are necessary to avoid ill-health, stunting and loss of capacities for independent productive living in adulthood. Some life-saving medicines cost less than a dollar, but they are underprovided due to commercial reasons. Unless effective redistribution happens, the purchasing power cannot be enhanced which is vital to afford even the basic necessities today, such as food, water and medicines.

Providing quality education is vital for achieving permanent poverty

exit, enhancement of skills and capacities, and to ensure upward social mobility. The financial institutions can come to the rescue once the people are able to hold enough assets and skills for the commercial entrepreneurship. But, much before that, people require survival and human capital development in the early stage of life.

Paul Romer, winner of 2018 Nobel Laureate in Economics worked on scarcity of positive externalities ideas. His policy suggestion was that there should be subsidies given and patents approved to engender ideas. But, weakly funded and indebted governments face problems in affording subsidies. Patents might provide incentives to the producers, but at the same time, it has resulted in under provision and overpricing of life-saving medicines for concentrating large profits of commercial manufacturers. An alternate is to address the ethical concern via culture and values. Quran (5:2) says: "Help you one another in good deeds and righteousness, but do not help one another in sin and transgression." Decentralized provision of public goods and services through *Zakāt* and *Waqf* can enhance the social safety net. There are mosque-based schools in the Muslim majority countries which effectively channelize *Zakāt* funds to ensure basic religious and secular education. Effective administration and management of the *Zakāt* funds can help in scaling up the benefits in terms of strengthening institutions to create synergistic effects.

Decent work and economic growth are necessary to realize a sustainable reduction in poverty and in ensuring upward socio-economic mobility. On one hand, *Zakāt* from endowment surplus households (those having higher wealth than *Nisāb*) to the endowment deficient households can help in providing income support and affordability for skills enhancement programs. *Zakāt* could also be used to provide funding for education and health

institutions, thereby contributing to human capital development which can provide decent work. On the other hand, the institution of *Zakāt* would ensure circulation of wealth in the productive enterprise, thereby directing capital to go in the real sector of the economy rather than sitting idle in the hands of the wealthy individuals.

## LITERATURE REVIEW

Wahid (1986) explains that *Zakāt* is a compulsory payment on the part of Muslims as a share to the poor, having a wide variety of economic and social ramifications. In the early empirical literature on welfare potential of *Infaq* (charity) to alleviate poverty in Pakistan, Malik et al (1994) use micro data to establish that *Infaq* (charity) does have a significant impact on reducing poverty gap. In a recent empirical study for OIC countries, Shirazi & Amin (2009) estimate the resources required for poverty elimination under \$1.25 a day and \$2.0 a day respectively. Their estimates for Pakistan suggest that Pakistan needs 1% of GDP for poverty elimination under \$1.25 a day and needs 6.77% of GDP for poverty elimination under \$2 a day. For Pakistan, Kahf (1989) uses different *Zakāt* categories and according to his estimate, *Zakāt* collection can be between 1.6% of GDP to 4.4% of GDP.

In a more recent study, Azam et al (2014) in an empirical study for Pakistan establish that *Zakāt* significantly enhances the welfare of the households. M. Akram & Afzal (2014) in an empirical study for Pakistan argue that *Zakāt* disbursement among the poor, needy, destitute, orphans and widows has played a significant role in poverty alleviation. Their results show that there is an inverse relationship between poverty and *Zakāt* disbursement both in the short run and in the long run.

Using aggregate data for Malaysia, Suprayitno et al (2013) find that *Zakāt* distribution has a positive, but small impact on aggregate consumption. Hence, *Zakāt* distribution should not be limited to the consumption needs, but should also cover other forms of monetary aid that can generate a continuous flow of income for *Zakāt* recipients. In another recent study, Abdelmawla (2014) argue based on empirical evidence using aggregated data for Sudan that *Zakāt* along with educational attainment significantly reduced poverty in Sudan.

In another empirical study for Bangladesh, Hassan and Jauanyed (2007) estimate that *Zakāt* funds can replace the government budgetary expenditures ranging from 21% of Annual Development Plan (ADP) in 1983-84 to 43% of ADP in 2004-2005. For Malaysia, Sadeq (1996) finds that about 73% of the estimated potential *Zakāt* collection will be needed annually to change the status of hard-core households to a status of non-poor households in Malaysia. Ibrahim (2006) contends in an empirical study for Malaysia that *Zakāt* distribution reduces income inequality. His analysis reveals that *Zakāt* distribution reduces poverty incidence, reduces the extent of poverty and lessens the severity of poverty. Firdaus et al (2012) estimate the potential of *Zakāt* in Indonesia by surveying 345 households. Their results show that *Zakāt* collection could reach 3.4% of Indonesia's GDP.

Some studies also show the comparative potential of *Zakāt* as a superior tool for poverty alleviation. Debnath et al (2013) assess the effectiveness of *Zakāt* as an alternative to microcredit in alleviating poverty in Bangladesh. Through the Propensity Score Matching (PSM) techniques, the study reveals that the impact of *Zakāt* scheme has proven to be greater than the microcredit programs. Besides that, the study also highlights that *Zakāt* scheme

significantly increases both income and expenditure of the recipients in comparison to the microcredit programs.

Some studies like Nadzri et al (2012) recommend integrating the various poverty alleviation and redistribution tools for creating synergies. The effectiveness of *Zakāt* institutions may improve by collaborating with other institutions such as Microfinance institutions. Shirazi (2014) suggests that the institutions of *Zakāt* and *Waqf* need to be integrated into the poverty reduction strategy of the Islamic Development Bank (IDB) member countries. The proceeds of these institutions should be made as part of their pro-poor budgetary expenditures. Hassan (2010) suggests a model which combines Islamic Microfinance with two traditional Islamic tools of poverty alleviation such as *Zakāt* and *Waqf* in an institutional setup. Hassan (2010) argues that the poor borrowers will have less debt burden as their capital investments will be partly met by funds from *Zakāt* that does not require any repayment.

Norazlina and Rahim (2011) identify that there are many types of programs that could be funded by *Zakāt* such as providing education for the poor, the establishment of schools, vocational training and rehabilitation for *Zakāt* recipients to make them more productive, establishment of agriculture and cottage industries, provision of fixed asset and equipment to small business projects, provision of working capital, building of low-cost housing and providing medical treatment and health care.

To achieve such diverse contemporary needs, the institution of *Zakāt* is very dynamic and flexible. In Umer (rta) and Abu Bakar (rta) period of government, *Zakāt* was collected by the government. But, in Usman (rta) period, people were allowed to pay *Zakāt* privately (Kuran, 2003). Horses were exempted from *Zakāt* in the Prophet's time, but, Umer (rta) brought them in the

*Zakāt* net in His period. Similarly, Mahmud (2001) argues that the institution of *Zakāt* is flexible to a certain degree as Umer (rta) levied *Zakāt* on horses and skins and at the time when Arab was hit with a drought and famine, he exempted poor from *Zakāt* and suspended *Zakāt* from the rich. Usman (rta) also levied *Zakāt* on the production in forests which was not the case in the earlier period (Nadvi, 1996). Hence, a policy maker in a modern economy can use this institution flexibly to maximize the welfare benefits of the *Zakāt* system.

Nevertheless, *Zakāt* is not collected by the government nowadays in most countries and is not considered a compulsory payment to the government (Powell, 2009). Ahmad et al. (2006) examine factors contributing to the dissatisfaction towards formal *Zakāt* institutions based on a sample of 753 respondents who paid *Zakāt* to six privatized institutions. Their study uses logistic regression to analyse the probability of paying to such *Zakāt* institutions. Their results indicate that the satisfaction on the distribution and efficient management of *Zakāt* are the main factors influencing *Zakāt* payment. About 57% of the respondents were dissatisfied with the distribution of *Zakāt* funds which significantly affects payments to the *Zakāt* institutions. Wahid et al. (2008) reveal two main factors contributing to dissatisfaction, i.e. the ineffectiveness of *Zakāt* distribution and the lack of transparency on information about the distribution of *Zakāt*. The lack of confidence in the governance of *Zakāt* institutions due to the perceived lack of efficiency and effectiveness may directly undermine the *Zakāt* institutions in attaining their desired socio-economic objectives.

Abu Bakar et al (2007) argue that there may be a lack of proper implementation of *Zakāt* in Muslim majority countries which limits the success of the noble aims of *Zakāt*.

Abdullah and Suhaib (2011) argue that if *Zakāt* is established as an institution, it will create a collective social security scheme for mutual help and the resources can be further utilized for social development.

Yusoff (2011) urges that every Muslim country must organize *Zakāt* collection and *Zakāt* spending in the most effective and efficient manner. Azam et al (2014) also suggest that there is a need to institutionalize the *Zakāt* collection system to increase the overall *Zakāt* collection. Rahman (2003) proposes the introduction of two *Zakāt* governance measures, i.e. the promulgation of Islamic accounting standard, and structural and policy reform towards more effective *Zakāt* distribution.

Besides governance, there is a dire need for a standardized approach on *Zakāt* base. Shirazi and Amin (2009) argue that since there is no agreement among the scholars on the new wealth that may be brought under the *Zakāt* net, there is an urgent need for the general agreement on the definition of the items, which may be taken as *Zakāt*able items. This requires *Ijma* (consensus) of the *ulama* (Islamic scholars) and other contemporary scholars on the issue.

On the need for extending the *Zakāt* net by including all forms of wealth and produce, Qardawi (1999, p. 333) applies the methodology of *Qiyas* (analogical reasoning) and reasons that the emerging and increasing types of wealth in modern times such as bank deposits and financial securities like shares and bonds are also *Zakāt*able (Qaradawi, 1999). Abu Bakar et al (2007) also suggest that the *illah* (basis or reasoning) for *Zakāt*ability should no longer be productive property, but any property which is in excess of one's personal use. Haneef and Mahmud (2011) also argue that the general directives of the *Quran* do not restrict the application of *Zakāt* to certain types of wealth to the exclusion of others.

That is why; wealth or assets subject to *Zakāt* should include cash in hand or at the bank, gold and silver, held-for trade inventory, real estate purchased for the purpose of resale and all types of financial investments in stocks, bonds, debentures, national saving schemes and mutual funds.

Likewise, production is not limited to agriculture nowadays. The major part of production comes from industries as well as services sector. Therefore, income from industrial production could also be taxed just like agriculture. Income from services sector could also be taxed on the same principle.

Next, we discuss another issue that whether the investment in financial instruments shall be subject to wealth *Zakāt* on total investment value or only the income from such financial investments shall be subject to income *Zakāt*. Khan (2005) contends that investment in stocks should be interpreted as any other investment with some means of earning income. Investment in a stock is a means of earning dividend income or capital gains. Just like means of production/income are exempted from *Zakāt*, investment in stocks should be exempted from wealth *Zakāt* as per that view. Therefore, any income arising from investment in stocks must be subject to income *Zakāt*. Similarly, this argument could be extended to introduce income *Zakāt* on mutual funds, investment in National Savings Schemes (NSS), debentures, bonds and related instruments. Furthermore, if a real estate is leased, the real estate becomes the means of earning rent for the owner. Hence, income *Zakāt* could also be introduced on rental income.

However, if employees or directors are given bonuses in the form of stock ownership, they will have to pay 5% *Zakāt* on income from investment in stocks. It is due to the fact that in this case, the participation in the business venture is not only by way of providing capital, but also by providing labor. One crucial advantage from this policy is that the directors will be willing to make the company grow and own its stock so as to benefit not only from the dividend/capital gains, but also to be able to pay less tax on that income i.e. 5% rather than 10%. This will also mitigate the agency problem as well in an effective way.

To summarize, we see that on theoretical grounds, *Zakāt* is an important economic institution. If the governments improve the governance, administration and effective and transparent use of *Zakāt* funds, then tremendous gains can be achieved in improving public welfare.

#### *Economic Effects of Islamic Redistribution Institutions*

In this section, we show how the institution of *Zakāt* impacts macroeconomic aggregates in an interest-free economy. We also want to highlight the impact of *Zakāt* on the wealth redistribution.

#### *Effects of Zakāt on Wealth Redistribution*

In this section, we present a simple illustration of how the institution of *Zakāt* in an Islamic economy reduces wealth concentration. For a particular individual, net *Zakāt* wealth at a point in time is given by equation (1):

$$W_t = Y_t - 0.025(NZW_{t-1}) + W_{t-1} - C_t \quad (1)$$

Here,

$Y_t$  is income of an individual in time period 't'.

$NZW_{t-1}$  is the base of wealth that will be used for *Zakāt* deduction.

$W_{t-1}$  is the wealth of individual 'i' in the previous time period.

$C_t$  is the consumption in time period 't'.

Simplifying equation (1), we get:

$$W_t = Y_t - 0.025(W_{t-1} - N_{t-1}) + W_{t-1} - C_t$$

$$W_t = Y_t - 0.025W_{t-1} + W_{t-1} + 0.025N_{t-1} - C_t \quad W_t = Y_t + 0.975W_{t-1} + 0.025N_{t-1} - C_t$$

Expanding it iteratively forward, we get

$$W_{t+1} = Y_{t+1} + W_t - 0.025(W_t - N_t) - C_{t+1} \quad W_{t+1} = Y_{t+1} + 0.975W_t + 0.025N_t - C_{t+1}$$

$$W_{t+1} = Y_{t+1} + 0.975(Y_t + 0.975W_{t-1} + 0.025N_{t-1} - C_t) + 0.025N_t - C_{t+1}$$

$$W_{t+1} = Y_{t+1} + 0.975I_t + 0.950625W_{t-1} + 0.024375N_{t-1} + 0.025N_t - 0.975C_t - C_{t+1} \quad (2)$$

It can be seen that the wealth function will deplete base year wealth as time moves on and the overall wealth can only increase with the increase in labor income and legitimate sources of non-

labor income in an interest free economy. In Table 1, we give a numerical example of wealth redistribution under the *Zakāt* system.

**Table 1.** Simulation of Wealth Redistribution under the *Zakāt* System

Year	$W_R$	Wealth Transfer (R to P)	$W_P$	$W_R$ to $W_P$ Multiple	$W_R$ to $W_P$ Multiple Per Person
0	10,100.00		100.00	101.00	505.00
1	9,850.00	250.00	350.00	28.14	140.71
2	9,606.25	243.75	593.75	16.18	80.89
3	9,368.59	237.66	831.41	11.27	56.34
4	9,136.88	231.71	1,063.12	8.59	42.97
5	8,910.96	225.92	1,289.04	6.91	34.56
6	8,690.68	220.27	1,509.32	5.76	28.79
7	8,475.92	214.77	1,724.08	4.92	24.58
8	8,266.52	209.40	1,933.48	4.28	21.38
9	8,062.36	204.16	2,137.64	3.77	18.86
10	7,863.30	199.06	2,336.70	3.37	16.83
11	7,669.21	194.08	2,530.79	3.03	15.15
12	7,479.98	189.23	2,720.02	2.75	13.75
13	7,295.48	184.50	2,904.52	2.51	12.56
14	7,115.60	179.89	3,084.40	2.31	11.53
15	6,940.21	175.39	3,259.79	2.13	10.65
16	6,769.20	171.01	3,430.80	1.97	9.87
17	6,602.47	166.73	3,597.53	1.84	9.18

18	6,439.91	162.56	3,760.09	1.71	8.56
19	6,281.41	158.50	3,918.59	1.60	8.01
20	6,126.88	154.54	4,073.12	1.50	7.52
21	5,976.20	150.67	4,223.80	1.41	7.07
22	5,829.30	146.91	4,370.70	1.33	6.67
23	5,686.07	143.23	4,513.93	1.26	6.30
24	5,546.42	139.65	4,653.58	1.19	5.96
25	5,410.26	136.16	4,789.74	1.13	5.65
26	5,277.50	132.76	4,922.50	1.07	5.36
27	5,148.06	129.44	5,051.94	1.02	5.10

Source: Author's Computations

Suppose we have an interest free economy that comprises 10 rich people each having wealth of RM 10,100. We also assume that there are 50 poor people each having wealth of RM 100. Let us suppose that the *Nisāb* amount in this interest free economy is RM 10 per person. Column 2 shows the aggregate wealth of rich people. Column 3 shows the wealth transferred from the rich to the poor each year. Column 4 shows the aggregate wealth of poor people after wealth transfer. For simplicity, we suppose perfect wealth equality between the people in each of the group. For the sake of highlighting the effect of wealth redistribution of wealth transfers, we assume that income is generated randomly in this interest free economy with no interest based lending allowed. Furthermore, we assume that income earned is consumed in that period to enable us to focus our attention on the wealth redistribution effect of *Zakāt* in an interest free economy. Column 5 shows the wealth multiple in each year for the two groups. It can be seen that after around 27 years, the wealth multiple will drastically go down from 101 to almost 1 for the two groups as a whole. Column 6 shows the wealth multiple per person. It can be seen that wealth multiple will become only 5 after 27 years from the initial value of 505. Eventually, the wealth recipients will become ineligible

for *Zakāt* receipts and rather will become part of the *Zakāt* payer group.

Table 2 presents a similar analysis with the assumption that there is a uniform 5% growth in endowments that rich and poor people experience. It can be seen that this growth does not affect wealth distribution. The redistribution is impactful both without and also with growth. Thus, redistribution is not dependent on business cycle or growth. Even if growth happens, it is egalitarian in this interest free economy in the presence of the institution of *Zakāt*.

Another interesting aspect is the boost in aggregate demand which is given in the last column of Table 2. The marginal increase in surplus wealth would mostly be saved by the rich. Since this wealth is transferred to the poor with little endowments, it is likely to be consumed. Thus, assuming a marginal propensity to consume value of 0.9, the last column of Table 2 presents the additional increase in aggregate demand which will happen every year in the interest free economy with a uniform growth rate of 5% and in the presence of the institution of *Zakāt*. This boost in aggregate demand would support the business cycle against economic slumps. Finally, this boost in aggregate demand is not a function of loose monetary or expansionary fiscal policy. Thus, it will not create the problem of inflation or

crowding out in the economy.

**Table 2.** Simulation of Wealth Redistribution under the *Zakāt* System with Growth

Year	$W_R$	Wealth Transfer (R to P)	$W_P$	$W_R$ to $W_P$ Multiple	$W_R$ to $W_P$ Multiple Per Person	Boost in AD
0	10,100.00		100.00	101.00	505.00	
1	10,339.88	252.50	357.50	28.92	144.61	227.25
2	10,585.45	258.50	633.87	16.70	83.50	232.65
3	10,836.85	264.64	930.20	11.65	58.25	238.17
4	11,094.23	270.92	1,247.63	8.89	44.46	243.83
5	11,357.71	277.36	1,587.37	7.16	35.78	249.62
6	11,627.46	283.94	1,950.68	5.96	29.80	255.55
7	11,903.61	290.69	2,338.90	5.09	25.45	261.62
8	12,186.32	297.59	2,753.44	4.43	22.13	267.83
9	12,475.75	304.66	3,195.77	3.90	19.52	274.19
10	12,772.05	311.89	3,667.45	3.48	17.41	280.70
11	13,075.38	319.30	4,170.12	3.14	15.68	287.37
12	13,385.92	326.88	4,705.51	2.84	14.22	294.20
13	13,703.84	334.65	5,275.44	2.60	12.99	301.18
14	14,029.31	342.60	5,881.81	2.39	11.93	308.34
15	14,362.50	350.73	6,526.63	2.20	11.00	315.66
16	14,703.61	359.06	7,212.02	2.04	10.19	323.16
17	15,052.82	367.59	7,940.21	1.90	9.48	330.83
18	15,410.33	376.32	8,713.55	1.77	8.84	338.69
19	15,776.32	385.26	9,534.48	1.65	8.27	346.73
20	16,151.01	394.41	10,405.61	1.55	7.76	354.97
21	16,534.60	403.78	11,329.67	1.46	7.30	363.40
22	16,927.29	413.36	12,309.52	1.38	6.88	372.03
23	17,329.32	423.18	13,348.18	1.30	6.49	380.86
24	17,740.89	433.23	14,448.82	1.23	6.14	389.91
25	18,162.23	443.52	15,614.78	1.16	5.82	399.17
26	18,593.59	454.06	16,849.57	1.10	5.52	408.65
27	19,035.18	464.84	18,156.89	1.05	5.24	418.36

Source: Author's Computations

### *Impact of Zakāt on Macroeconomic Outcomes*

Hartman (2002) cites the case of the US economy and argues that the progressive taxes were designed to reduce income inequality. But during the last four decades, while the share of income taxes levied on the upper tenth of incomes rose

15%, the after-tax income share of the remainder of incomes declined 13%. He concludes that progressive taxation has failed to reduce the disparity of real incomes.

Mainstream economic theory and policy based on it has not been able to create an equitable balance between the capitalists and the labor class, especially

in the presence of extractive institutions like interest based earnings on accumulated wealth and incapacitated wealth redistribution mechanisms. In Table 3, we present net ODA and official aid received in selected OIC countries. In terms of absolute figures, Afghanistan, Syria, Pakistan, Egypt and Turkey

received the highest assistance in absolute numbers. However, when we look at the assistance received on per capita basis, we find that OIC countries with the greatest number of the poor population receive very low assistance on per capita basis.

**Table 3.** Net ODA and Official Aid in Selected OIC Countries

Country	Net ODA + Aid (mln \$)	ODA + Aid Per Capita	Country	Net ODA + Aid (mln \$)	ODA + Aid Per Capita
Gaza	2,481	560.98	Niger	914	45.96
Jordan	2,677	352.43	Guinea	561	44.51
Kosovo	576	319.53	Turkey	3,410	43.34
Syria	4,330	234.04	Yemen	1,150	42.87
Guyana	165	214.84	Tajikistan	356	41.99
Djibouti	164	184.44	Uganda	1,622	41.56
Bosnia	631	165.69	Cote d'Ivoire	917	40.41
Afghanistan	4,801	147.60	Egypt	3,510	38.35
Lebanon	816	139.46	Iraq	1,389	38.13
Sierra Leone	882	136.68	Cameroon	842	36.09
Kyrgyz Rep.	651	109.29	Libya	207	33.03
Somalia	1,106	102.52	Togo	207	28.37
Albania	280	96.94	Chad	386	27.53
Comoros	74	93.55	Suriname	13	23.15
Tunisia	930	82.68	Sudan	867	21.54
Mozambique	2,096	74.92	Pakistan	3,584	18.97
Senegal	1,104	72.98	Bangladesh	2,412	14.98
Mali	1,233	70.05	Nigeria	2,437	13.37
Morocco	2,228	64.81	Uzbekistan	324	10.36
Gabon	111	64.27	Turkmenistan	35	6.44
Mauritania	257	63.25	Kazakhstan	88	4.99
Maldives	25	62.00	Algeria	156	3.92
Burkina Faso	1,115	61.57	Iran	77	0.98
Guinea-Bissau	109	58.92	Malaysia	10	0.33
Benin	596	54.79	Indonesia	-442	-1.71
Gambia	98	49.35			

Source: World Development Indicators 2015

In Table 4, we show the debt service burden on OIC countries in terms of how much of their GNI is paid as interest payments on external debt. We notice that countries with high incidence

of poverty like Gabon and Mozambique pay as much as 1.5% and 1.4% of their GNI in interest payments alone on their external debt. Out of 46 countries listed in Table 4, there are 16 OIC countries

whose interest payments alone exceed 1% of GNI. If these countries receive interest free loans or loans at concessional terms, their debt service burden can be significantly reduced and the savings can be used for funding development projects. On the other hand, we notice from Table 3 that there are at least 15 OIC countries which receive net ODA lower than 1% of their GNI. This suggests that in some OIC countries, the net outflow of resources in the form of interest payments would be greater than inflows received in the form of development assistance. Specifically,

we discover that in at least 9 countries, the interest payments as a percent of GNI exceed net ODA received as a percent of GNI. These 9 countries include Kazakhstan (-2.08), Lebanon (-1.48), Indonesia (-1.27), Turkey (-1.11), Malaysia (-1.0), Gabon (-0.71), Tunisia (-0.42), Guyana (-0.13) and Algeria (-0.01). The numbers in parentheses indicate the difference between the net ODA received as a percent of GNI and the interest payments on the external debt as a percent of GNI.

**Table 4.** Interest Payment on External Debt (% of GNI) for Selected OIC Countries

Country	Interest on External Debt (% of GNI)	Country	Interest on External Debt (% of GNI)
Lebanon	3.580	Maldives	0.431
Kazakhstan	2.132	Pakistan	0.428
Bosnia	1.657	Azerbaijan	0.363
Tunisia	1.556	Benin	0.288
Gabon	1.448	Niger	0.286
Turkey	1.408	Egypt	0.272
Mozambique	1.366	Mali	0.262
Tajikistan	1.343	Yemen	0.219
Jordan	1.333	Burkina Faso	0.202
Indonesia	1.266	Guinea	0.186
Mauritania	1.224	Sierra Leone	0.186
Kyrgyz Republic	1.217	Bangladesh	0.162
Senegal	1.108	Uganda	0.161
Morocco	1.107	Sudan	0.124
Guyana	1.107	Guinea-Bissau	0.103
Malaysia	1.032	Chad	0.087
Cote d'Ivoire	0.989	Nigeria	0.079
Kosovo	0.981	Algeria	0.067
Albania	0.673	Afghanistan	0.050
Gambia	0.647	Comoros	0.021
Cameroon	0.555	Iran	0.020
Togo	0.537	Turkmenistan	0.017
Uzbekistan	0.456	Somalia	0.001

Source: World Development Indicators 2015

In an Islamic economy, the wealth redistribution through *Zakāt* and inheritance laws ensures circulation of wealth. Aaron (1992) argues that if

wealth confers economic, social and political power and hinders social mobility, then taxing wealth can reduce wealth concentration. On the other hand,

prohibition of interest closes the door for riskless non-labor income on money capital. This increases the cost of leisure and encourages the person to supply more labor and/or invest money capital in the productive enterprise.

Islam removes the extractive institutions that perpetuate income and wealth inequality in an economy, especially the institution of interest and freedom to devise tax policy for the elite interest groups in capitalistic democracies that put the welfare of future generations in jeopardy by excessive deficit financing and inflation tax. In this sense, the Islamic approach to redistribution is both Millian and Ricardian at the same time. Islam's worldview with belief in afterlife accountability and the concept of property rights held as trust ensure that the behavior of economic agents incorporates ethical and equity concerns in their economic choices. By removing extractive institutions like interest on money capital, the income creation process is directly influenced. Then, the income created from the productive enterprise is itself redistributed as flows in the economy by taxing the stock of wealth.

Adam Smith in his monumental work "*An inquiry into the nature and causes of the wealth of nations*" discusses the cannons of taxation. The *Zakāt* based taxation system goes very well with Adam Smith's canons of taxation. It has a proportional tax and it does not tax production heavily. It is also simple and certain. It is convenient to collect and more so, because it is a religious obligation than just an involuntary tool for fetching wealth. It only taxes those who have the ability to pay i.e. it does not tax those who do not reach a minimum threshold of wealth in their hands. It can be appreciated from the classification of rates on production value tax that there is least *Zakāt* on the value of production which intensively uses inputs and most *Zakāt* when the production comes from

the negligible use of inputs (Siddiqui, 1982).

On the macroeconomic front, the proportional *Zakāt* linked with income acts as an automatic stabilizer (Yusoff, 2010). When aggregate personal disposable income increases in economic booms, more *Zakāt* is collected and more amount is available to the government for increasing transfer payments to *Fuqarah* (poor and needy), *Masakeen* (extremely poor and needy) and *Gharimeen* (borrowers in trouble). When aggregate personal disposable income decreases in recessions, obligatory *Zakāt* also decreases and thereby providing an automatic relief to the income earners when the incomes decline.

Besides the proportional income levy, *Zakāt* on wealth redistributes wealth and reduces wealth concentration. So, if an economy is in disequilibrium and policies fail to immediately recover and boost incomes, wealth *Zakāt* enables the distributive allocation that works independently of the business cycles and helps in stabilizing the extremes of the business cycles. In this way, wealth *Zakāt* acts as a permanent stabilizer.

When the personal disposable incomes decline in recessions, more people will become eligible for *Zakāt*. Since *Zakāt* is levied on both income and wealth, the redistribution of wealth will always be functional and operative in an Islamic economy due to wealth *Zakāt*. Transfer payments to the unemployed, poor, needy and debtors will continue even when the economy faces a recession.

Besides this, a consistent and credible low tax rate policy with broader *Zakāt* base will help to minimize distortions, boost aggregate demand, encourage investment by decreasing costs of doing business and this could also simultaneously solve the microeconomic problems of imperfection in markets by increasing competition and reducing market power.

A uniform *Zakāt* levy on wealth and produce can result in tax rate smoothing, stabilization of business cycle and encourage long-term investments and decision making without leaving the long-term planner in the private sector to worry about fiscal policy reversals (i.e. Ricardian equivalence).

One possible question may arise here as to how such lenient tax rates would increase substantial public revenue. The answer to this is given by the Laffer curve. Laffer (2004), a supply-side economist, himself noted that Muslim philosopher Ibn-e-Khaldun wrote about it in “The Muqaddimah”. Higher tax rates discourage entrepreneurship as they decrease the incentive to produce. Lower tax rates encourage entrepreneurship and hence increase the size of the production sector and hence production. With the increase in production, tax revenue in amount increases because of a larger base. Hence, lower tax rates can still ensure high tax to GDP ratio.

*Zakāt* is an important tool for redistributing income and it can also increase aggregate spending. Metwally (1983) argues that *Zakāt* has a wider base and it is applicable to both the incomes and wealth. He emphasizes that the *Zakāt* system has an inbuilt mechanism to reach the right targets in terms of *Zakāt* collection and disbursement. This ensures increasing the propensity to consume more emphatically and quickly.

Ahmad (1987) shows in a Keynesian model of the aggregate economy that expenditure multiplier in the presence of *Zakāt* and *Infaq* (charity) institutions will be higher than in a capitalist economy. Since *Zakāt* redistributes income from rich to the poor with direct incidence, the higher MPC for poor can also increase aggregate spending. Carroll and Kimball (1996) argue that when the income uncertainty is introduced in the standardized optimization problem, the consumption

function becomes concave. Keynes (1935, p. 31) notes that the MPC is weaker in a wealthy community and as the wealth increases, the MPC starts to diminish. Empirical studies such as Souleles (1995) and Lusardi (1992) also find similar results and conclude that the MPC is considerably higher for consumers with low wealth or low income as compared to consumers with high wealth or high income. Murugasu et al. (2013) in a study in Malaysia find that MPC for lower income groups is higher than MPC for higher income households. Jappelli and Pistaferri (2014) provide empirical evidence from Italy which shows that households with low cash-on-hand exhibit a much higher MPC than affluent households. Hence, the redistribution from people with lower MPC to people with higher MPC will boost aggregate spending even with the same level of income as shown before with a simple numerical simulation above.

Lastly, there will be downward pressure on the prices of durable goods with a wealth tax on tradable inventory while allowing an exemption on assets in use. For instance, if a furniture, consumer appliance or residential facility is unsold at year-end, the seller will have to pay *Zakāt* on it. But, if the asset is sold to the buyer before the due date of *Zakāt*, then the subsequent owner while using such assets personally will not have to pay *Zakāt* on these assets. This will help in checking inflation, clearing markets and promoting efficient production processes to reduce inventory cost including a physical and fiscal levy on unsold inventory at year-end. However, to avoid *Zakāt* arbitrage, the government has to randomly assign *Zakāt* due date for different retailers. It can also enact a policy to levy wealth *Zakāt* on tradable inventory as an average of ending and beginning inventory to counter *Zakāt* arbitrage.

### *Institutionalizing Zakāt in Contemporary Economy*

In this section, we outline recommendations at the policy and implementation level so that the institution of *Zakāt* can be effectively utilized to contribute in poverty alleviation.

- ❖ It is necessary that the poor people are provided with *Zakāt* as transfer payment for a necessary number of periods so that they can survive as well as permanently move to the status of non-poor. In this regard, the public sector educational and health institutions need to provide effective and affordable services with state of the art quality so that the income earning capacity of these poor people can be enhanced along with ensuring their survival and meeting the basic physiological needs of life.
- ❖ It is highly important that the scale and efficiency of public sector institutions in health and education are improved and poor people are provided with education, vocational training, and basic health facilities at affordable cost. In this regard, the institution of *Waqf* (charitable trust) can also be very effective in helping the government to increase its scale of welfare programs and outreach. Social mobility rests on effective income and capacity enhancing support programs rather than just on direct cash transfers.
- ❖ The close interaction between the *Zakāt* disbursement agency and the Islamic microfinance institutions is also vital. Microfinance institutions can help in identifying targets that require immediate help in meeting consumption expenditure requirements.
- ❖ For effective organization and with the objective of maximizing the benefits of *Zakāt*, it is appropriate to disburse *Zakāt* at the federal level. This way the regional disparities can be reduced more effectively.
- ❖ To gain the trust and confidence of people, it is vital to improve governance and transparency. Collection and disbursement details shall be reported in a standard way periodically.
- ❖ Creating synergies between *Zakāt* and other welfare programs is vital. Sufficient collection of *Zakāt* for filling the poverty gap is not enough to end poverty. It is important that *Zakāt* funds be disbursed to the right people and through right channels. It is also important to utilize the existing welfare programs for *Zakāt* disbursement so that the right targets can be reached more efficiently.
- ❖ It is important to modify the accounting standards to achieve transparent computation, assessment and collection.
- ❖ It is vital to improve the capacity of the public sector officials to scrutinize accounts for transparent and efficient *Zakāt* assessment.
- ❖ Pooling resources by transferring surplus *Zakāt* funds from the rich countries to the poor countries with lower wealth bases will help in alleviating poverty quickly across the Muslim majority countries (Shirazi & Amin, 2009).
- ❖ The timing for wealth *Zakāt* is especially important. It is better to have an equal number of people paying *Zakāt* every quarter rather than all paying at a single time of the year. This will help in reducing any possible arbitrage and enable the government to

have *Zakāt* funds available at all times of the year.

- ❖ In direct transfers, it is vital to give enough *Zakāt* per person so that the person can come out of poverty and the objective of social mobility can be achieved (Mahmud & Haneef, 2012).
- ❖ While there is *Zakāt* on assets in personal use, the government in consultation with Islamic scholars has to legislate what comprises the regular and ordinary cost of living per person for different income groups. While the government shall not intervene in restraining consumption; at the same time, it shall also not allow people to avoid *Zakāt* by maintaining an extra ordinary living standard.
- ❖ Using same legal and administrative infrastructure established for the collection and disbursement of *Zakāt*, the government can invite more voluntary charitable giving besides *Zakāt* from domestic and overseas residents so that the scale and effectiveness of redistribution and welfare programs can be enhanced.

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## Exploring the Potential of *Zakah* for Supporting Realization of Sustainable Development Goals (SDGs) in Indonesia

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### ABSTRACT

*Sustainable Development Goals (SDGs) is a universal call to end poverty, protect the planet and ensure that all people enjoy peace and prosperity; goals which are strongly in line with the objective of Islam (maqasid al syariah). Despite of global acceptance of the concept, however, financing issues remain the biggest challenge for realizing the SDGs. Innovative financing through partnership with religious and other institutions, therefore, has been recommended. With this perspective, this study aims to explore the potential of zakah to support financing and realizing the goals in Indonesia. This is done by identifying factors that influence the intention of Muslims to pay zakah and exploring the SDGs' clusters prioritized to be financed from the zakah funds. The study collected primary data from 304 respondents living in Greater Jakarta area of Indonesia and utilized the Theory of Planned Behaviors (TPB) approach to frame the intentions. It also used descriptive statistics and Structural Equation Modeling (SEM) to analyze the data. The findings suggest that three TPB variables, namely attitudes, subjective norms and behavioral control, have a positive influence on the Muslims' intention to pay zakat. Additionally, attitudes are influenced by religiosity, knowledge and trust to zakah organizations. Furthermore, of the five objective clusters' in the SDGs, the people cluster (which includes objectives such as poverty reduction, education and health improvement) received the highest priority in the perceptions of the Muslims regarding the use of zakah for financing SDGs. The findings highlight the potential of zakah in supporting achievement of SDGs in Indonesia, something that might be useful for government, NGOs, zakah organizations and other zakah stakeholders.*

*Keywords: Zakah and SDGs; intention to pay zakah; Zakah in Indonesia; Financing of SDGs; Innovative Financing.*

### INTRODUCTION

The 2030 Agenda for Sustainable Development, known as the Sustainable Development Goals (SDGs), is a universal call to end poverty, protect the planet and ensure that all people enjoy peace and prosperity. The SDGs consists of 17 goals and 169 targets. They balance the economic, social and ecological dimensions of sustainable development, and place the fight against poverty and sustainable development on the same agenda for the first time (UN, 2018).

The universal call is responded positively worldwide and commitment to SDGs has been shown by many countries, including Indonesia. It is evident that President Joko Widodo's nine national priorities and the country's Medium-Term Development Plans (RPJMN) align well with the SDGs. Furthermore, after mapping the goals and targets of the national plan with the SDGs, the National Development Planning Agency (Bappenas) suggested that 108 out of 169 SDG targets are matched with the RPJMN (Brodjonegoro, 2018).

Ending poverty and achieving the other objectives of SDGs, however, are no easy tasks. One major challenge for achieving the SDGs is limited financing. Traditionally, the funding comes from government budget, official development assistance and loans from multilateral financial institutions. Nevertheless, they are no longer sufficient for achieving the SDGs. World Economic Forum (2015) estimated that the current gap of investment (that is the difference between the total investment needed and the available traditional development fund) in critical sectors reached \$3.1 trillion. Therefore, it is necessary to further improve sources of fund through partnerships with private, religious and other sectors.

*Zakah* can be a supporting source of the fund because *zakah* is basically aimed at reducing poverty and ensuring social justice. In Islam, the vision of human welfare does not only revolve around the realization of income and wealth equity but also to fulfill spiritual and non-material needs in addition to sustaining long-term economic development (Chapra, 2008). The need for achieving this prosperity has been discussed in Islamic literature with the concept of *maqasid al-shariah* (the purpose of sharia). The reason for the

existence of *maqasid al-shariah* is to fulfill the interests (*jalb al-masalih*) of all mankind and avoid danger (*daf 'al-mafasid*). Imam al-Ghazali classified the *maqasid al-shariah* into five main categories, namely protection of faith (*din*), life (*nafs*), intellect (*'aql*), lineage (*nasl*), and wealth (*mal*) (Chapra, 2008).

As the country with the largest Muslim population in the world, Indonesia has a very big *zakah* potential as well. According to the National Board of Zakat (BAZNAS) data in 2015, the potential of national *zakah* reached Rp217 trillion. However, the national *zakah* potential has not been achieved optimally. Until 2016, the total funding of *zakah*, infaq, and alms (ZIS) funds reached Rp5 trillion, 74.51 percent of which were *zakah* funds, accounting to more than Rp3.7 trillion. These figures show that the realization of *zakah* fund collection in Indonesia is still very far from its potential. Not only from the collection, the distribution of *zakah* funds needs to be developed. The total amount of ZIS funds distributed nationally reached Rp2.9 trillion in 2016, showing the absorption of 58.42 percent of funds collected. The absorption rate of national ZIS funds has decreased from the previous year, which was 61.6 percent (Pusat Kajian Strategis, 2016).

**Table 1.** Proportion of *Zakah* Allocation Fund based on Distribution Sectors

No	Sectors	2015 (in Rupiah)	%	2016 (in Rupiah)	%
1.	Economy	338,030,622,008	15.01	493,075,489,398	18.30
2.	Education	458,195,272,997	20.35	842,980,341,134	31.28
3.	Dakwah	334,749,823,815	14.87	418,454,281,897	15.53
4.	Health	191,419,750,663	8.50	226,004,399,823	8.39
5.	Social	929,239,276,062	41.27	714,267,956,361	26.51
TOTAL		2,251,634,745,545	100	2,694,782,468,613	100

Source: Indonesia Zakat Outlook, 2017

With this perspective, this study aims to explore the potential of *zakah* to support financing and realizing the SDGs in Indonesia. This is done by identifying

factors that influence the intention of Muslims to pay *zakah* and exploring the SDGs' clusters prioritized to be financed from the *zakah* funds. As far as we

concern, few studies attempt to address this issue. While this is probably related to the fact that the SDGs is a relatively new global development agenda which was just issued in 2016, replacing the Millennium Development Goals (MDGs) ended in 2015. Not only that, linking zakah with SDGs is also a relatively new discourse in Islamic economics.

The study collected primary data from 304 respondents living in Greater Jakarta area of Indonesia and utilized the Theory of Planned Behaviors (TPB) approach to frame the intentions to pay zakah. It also used descriptive statistics and Structural Equation Modeling (SEM) to analyze the primary data and identifying the SDGs' clusters prioritized to be financed from the *zakah* funds.

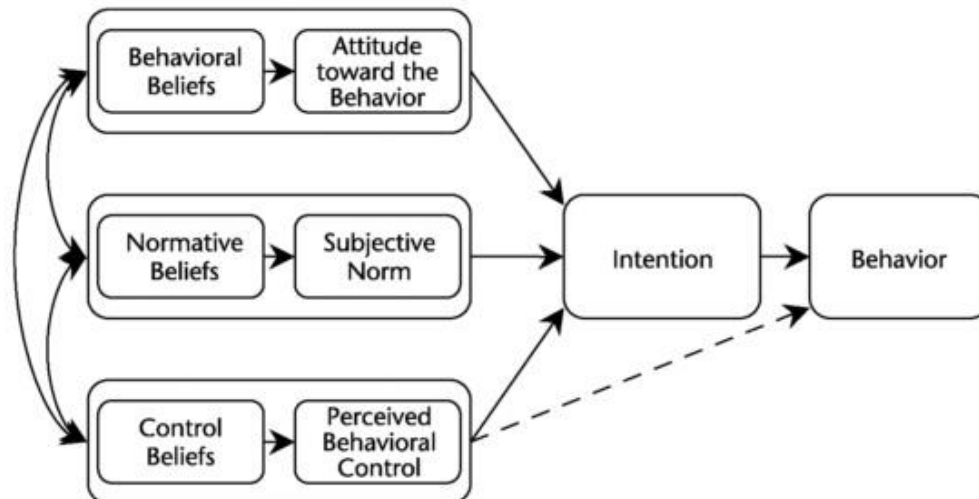
To proceed, the paper is structured as follow. Section two reviews relevant literature and subsequently develop the relevant hypotheses. Section three explains the research methods, while section four discusses the findings and analyses. The final section makes conclusions and recommendations of the study.

#### LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

There have been a number of previous researches on the influence of the theory of planned behavior (TPB) factors on the behavior of paying *zakah*. Attitude, subjective norms, and perceived behavioral control have been shown to have positive and significant influence on the behavior of obedience to pay *zakah* (Al Jaffri Saad & Haniffa, 2014; Azman & Bidin, 2015; Haji-Othman, Alwi, Sheh Yusuff, & Mohd Saufi, 2017; Idris, Bidin, & Saad, 2012; Muhammad & Saad, 2016;

Sapingi, Ahmad, & Mohamad, 2011b). Other variables that are extensions of TPB such as knowledge, religiosity and trust also positively and significantly influence the behavior of paying *zakah* (Azman & Bidin, 2015; Haji-Othman, Alwi, et al., 2017; Idris et al., 2012; Mukhlis & Beik, 2013; Oladimeji Abioye Mustafa, Har Sani Mohamad, & Akhyar Adnan, 2013).

This study extends the theory of planned behavior (TPB) proposed by Icek Ajzen. According to this theory, human behavior is guided by three considerations: beliefs about the possible consequences of behavioral beliefs, beliefs about normative beliefs, and beliefs about the existence of factors that may facilitate or impede the conduct of behaviors (control beliefs). From behavioral beliefs or behavioral beliefs then generate the desired or undesirable attitude toward the behavior (attitude toward the behavior); normative beliefs or normative beliefs produce social pressures or subjective norms, and beliefs of control or control beliefs result in perceived behavior control (perceived behavioral control). The combination of attitudes, subjective norms and perceived behavioral controls leads to the formation of behavioral intentions. TPB is an extension or development of a theory of reasoned action (TRA) previously proposed by Ajzen as well, by adding a perceived behavior control variable to the TPB. A person is expected to work on their intentions when the opportunity arises so that intentions or intentions are assumed to be antecedents that immediately lead to behavior. However, many difficult behaviors that can limit the control of the will (volitional control), so that perceived behavioral control should be considered in addition to intention (Ajzen, 2005).

**Figure 1.** The conceptual framework of the theory of planned behavior (TPB)

Source: Ajzen, 2005

### *Attitude toward zakah and intention*

Attitude towards a behavior can be defined as a person's tendency to assess positively or negatively a behavior. According to TPB, attitude towards a behavior is determined by accessible beliefs about the consequences of the behavior. This is commonly referred to as behavioral beliefs. Any behavioral belief links behaviors with certain outcomes or other attributes such as the cost incurred from performing such behavior. Attitude towards a behavior is determined by a combination of behavioral beliefs and outcome evaluation. These two factors can be found in the salient belief of a behavior. Salient belief is a common assumption used by a particular group to assess a behavior. The evaluation of each salient belief influences the attitude in proportion to the subjective probability that the behavior will produce a questionable result.

Several studies have been conducted to examine the effect of attitude on behavior to pay *zakah*. Azman & Bidin (2015) and Haji-Othman, Alwi, Yusuff & Saufi (2017) found that attitude has a significant effect on compliance behavior to pay *zakah* on income. Saad and Haniffa (2014) found that the intention, influenced by attitude and subjective norms, became a

significant predictor of compliance behavior to pay *zakah*. In other words, the intention becomes a mediator of the influence of attitude and subjective norms. Hence, the following hypothesis is proposed:

*H1. Attitude towards zakah has a positive influence on the intention of muzakki to pay zakah*

The behavior observed in this research is towards paying *zakah*. Thus, the salient beliefs are religiosity, trust, and knowledge.

### *Religiosity*

Religiosity means religious devotion or piety. Meanwhile, McDaniel and Burnett (1990) define religiosity as "belief in God accompanied by a commitment to follow the principles believed to be ordained by God." Another definition for religiosity is the condition or state of being religious (O'Brien & Palmer 1993). Religiosity is a multidimensional concept and encompasses the various elements of religion which are beliefs, practices, knowledge, experiences, and effects of such elements on everyday activities (O'Connell, 1975).

Several studies have shown that religiosity has a significant positive and

significant influence on the intention to pay *zakah* (Haji-Othman, Alwi, et al., 2017; Haji-Othman, Sheh Yusuff, Mohd Saufi, & Hafsha, 2017; Idris et al., 2012). Religiosity also has a positive influence on investor behavior in Sukuk especially during Ramadan (Klein, Turk, & Weill, 2017). Religiosity also has a minimal but statistically positive and significant influence on compliance to pay voluntary taxes (Mohdali & Pope, 2014). Meanwhile, the study of Azman and Bidin (2015) shows that religiosity is not a factor that is so important to the behavior of *zakah* paying compliance, which is probably caused by paying directly to *mustahik* instead of to the *zakah amil* institution (LAZ). However, religiosity still shows a positive influence on compliance to pay *zakah* (Azman & Bidin, 2015). Thus, the next hypothesis that is formed is:

*H2. Religiosity has a positive influence on the attitude of the muzakki towards the intention of muzakki to pay zakah*

#### *Trust*

Etymologically, the term trust is defined as the assumption or belief that something that is believed to be true or real. Meanwhile, the term trust usually refers to a situation marked by one party (trustor) who is willing to rely on the actions of another party (trustee) (Mayer, Davis, & Schoorman, 1995; Walter, 2010). In this study, trust is the extent to which the trust *muzakki* has to *amil* (manager) of *zakah*.

Some previous studies have proven that information on *zakah* and taxes influence the payment of *zakah* or taxes. The perception of firm credibility - in which case the level of trust *muzakki* has for *zakah* agencies - also positively and significantly change the behavior to pay *zakah* (Azman & Bidin, 2015). Thus, the following hypothesis is:

*H3. Trust towards zakah agencies has a positive influence on the attitude of muzakki towards the intention to pay zakah*

#### *Knowledge*

Ajzen (2005) explains that knowledge can influence an individual's attitude toward a behavior. In this study, knowledge refers to *muzakki's* knowledge on the concept and utilization of *zakah*.

Knowledge is an important component that can influence attitudes and perceptions (Fallan, 1999). Previous research has also shown that knowledge has an influence on the behavior of paying taxes or *zakah*. Knowledge of taxes has an influence on tax awareness and compliance to pay taxes (Andreas & Savitri, 2015). Knowledge also has a positive and significant influence on the intention to pay *zakah* (Haji-Othman, Sheh Yusuff, et al., 2017). In the case of charity giving, it was found that people with higher levels of education tend to be more charitable or give donations (Awaliah Kasri, 2013). The hypothesis which then formed is as follows:

*H4. Knowledge of zakah has a positive influence on the attitude of muzakki towards the intention to pay zakah*

#### *Subjective norm and intention*

Ajzen (1991) defines subjective norms as the perceived social pressure when conducting a behavior. The subjective norm refers to a person's perception of a relevant opinion from others about whether to perform the behavior. "References" that are important for influencing include parents, spouses, close friends, co-workers, and, depending on the behaviors involved, experts. The belief underlying subjective norms is called normative belief. In general, the person who believes that his referenced figure approves of a behavior will do the behavior. Conversely, when most of the

references do not approve of the behavior, it will put pressure on someone to avoid the behavior. Motivation to meet the expectations of the reference is called motivation to comply. Subjective norms can be assessed directly by asking respondents to assess how likely that most people who are important to them will agree on the behavior given (Ajzen, 1991). Thus, the next hypothesis is as follows:

*H5. Subjective norm has a positive influence on the intention of muzakki to pay zakah*

### ***Perceived behavioral control and intention***

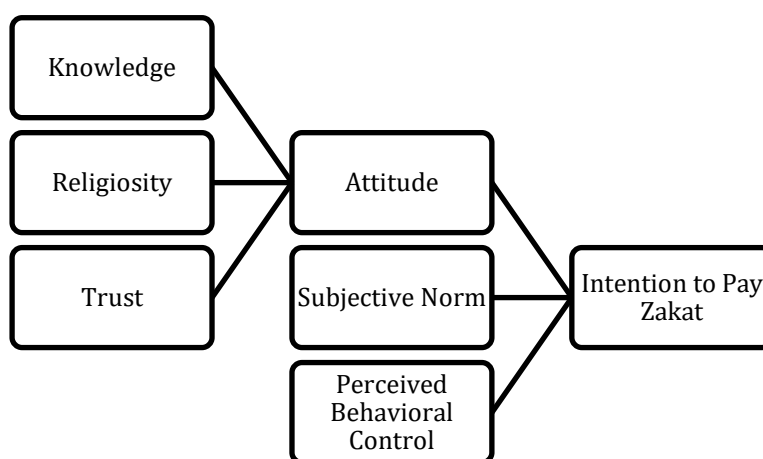
Perceived behavioral control has an important role in TPB, which is also a variable that differentiates TPB from TRA. The current concept of perceived behavioral control is in accordance with Bandura's concept of self-efficacy (1977, 1982), in which one's behavior is strongly influenced by their self-confidence in their own ability to do so. TPB places the construction of self-efficacy or perceived behavioral control beliefs within a more general framework of relationships between beliefs, attitudes, intentions, and behaviors (Ajzen et al., 1991).

According to TPB, perceived behavior control with intention can predict the attainment of a behavior. There are at least two reasons that support the hypothesis. First, assuming constant intention attempts to resolve a behavior tend to increase with perceived behavioral control. Second, perceived behavior control can often be used as a substitute to measure actual control over a behavior. Perceived behavioral control becomes less realistic when the information possessed about the behavior is minimal or when there are foreign elements entering the situation of the behavior. However, when its behavioral control is realistic, it can be used to predict the success of the behavior (Ajzen, 1985 in Ajzen, 1991). Thus, the hypothesis is formed as follows:

*H6. Perceived behavioral control has a positive influence towards the intention of muzakki to pay zakah*

Based on the literature reviewed, the conceptual framework for determining the factors affecting the intentions to pay zakah is developed and illustrated in Figure 2. While the research methods, including for identifying the SDGs' clusters prioritized to be financed from the *zakah* funds, will be discussed in the next section.

**Figure 2.** Conceptual framework of the research



Sources: Author's modification from Ajzen (2005) and Shukor, et al. (2017)

## RESEARCH METHOD

### *Research Design*

The research approach used in this research is the quantitative approach. A quantitative approach is an approach that emphasizes the hypothesis test, where the analyzed data are measured and will produce a generalizable conclusion. This type of research is descriptive, where in general this research will explain the factors that become the determinants of intention of *muzakki* to pay *zakah* with the theory of planned behavior (TPB) approach and describing the SDGs' clusters prioritized to be financed from the *zakah* funds.

### *Population and Sampling*

The target sample in this study is taken from elements of the Muslim population in Indonesia who have already paid *zakah* (*muzakki*), in particular, income *zakah*. In this study, the sample size used refers to the opinion of Hair et al. (2006) that the sample size in the study should have a minimum number of five times the number of questions or statements to be analyzed. Therefore, the number of respondents used in this study is a minimum of 185 samples, obtained from 37 statements multiplied by five.

The sampling method used is the non-probability sampling, where the type of non-probability sampling selected is convenience sampling and purposive sampling. With convenience sampling technique, samples are selected from the population element that is easy to reach by researchers. Meanwhile, with purposive sampling, the sample is selected based on the assessment or criteria that have been determined by the researchers in accordance with the purpose of the study. Because the research of interest in this study is the intention of paying *zakah*, then the sample is taken from the Muslim population who have paid *zakah* (*muzakki*)

in Indonesia. The criteria determined are Muslims in Indonesia who have paid income *zakah* in the past year.

The data is collected through a survey using an online questionnaire consisting of five parts. The first part contains a screening question. The second section contains questions related to respondents' demographic data. The third section contains general questions that include the *zakah* behavior of respondents. The fourth section contains statements related to each dimensions of the TPB included in the research indicator, using the Likert scale with five choices of strongly disagreeing (option 1) to strongly agree (option 5). The final section contains questions related to the SDGs sectors prioritized to be financed from the *zakah* funds. It should also be noted that the questionnaires are distributed online through social media to facilitate the acquisition of the number of respondents required.

### *Data Analysis*

#### *Sample Profile*

The author distributed an online questionnaire for three weeks and obtained 345 respondents. Of the 345 respondents, 41 respondents did not pass the screening questions (not / have not paid *zakah* profession in the past year) and/or data did not meet the research needs (partial or incomplete data input). In the end, 304 respondent data were used for processing. From the data obtained, 53 percent of respondents are men while female respondents as much as 47 percent. The majority of respondents are in the age range of 20-30 years, as many as 49 percents of the total respondents. Of the total respondents, the proportions of both married and unmarried respondents are similar, where each category holds 48 percent of the total respondents, while the rest are divorced (5 percent). The majority of respondents work as private employees,

as many as 44 percents of the total respondents.

#### *Structural Equation Modelling (SEM)*

Structural Equation Modeling (SEM) is an analytical method that combines three simultaneous analysis approaches: checking the validity and reliability of the instrument (factor analysis), testing the relationships between models (path analysis), and finding the most suitable model for regression estimation (structural analysis). SEM uses various models to illustrate relationships among variables (be it observed variables and/or latent variables, independent or dependent), with the basic purpose of providing quantitative testing of theoretical models hypothesized by the researcher.

In the SEM analysis, there are two model analyses. First, the measurement model is the initial model used to see how big the indicators are able to represent latent variables. Second is the structural model which shows the dependency relationship between latent variables.

#### Measurement Model Analysis

To know whether the indicator can actually be used as an indicator of the latent variable, it is necessary to test the measurement model. The form of analysis performed to test the measurement model consists of the validity test, reliability test, and goodness of fit test. Validity test is a test conducted to test or measure the accuracy of indicators in representing latent variables. Validity test is done by looking at the value of the standard loading factor and t-value indicator shown in the path diagram using LISREL software. An indicator is stated to have good validity if it is known: (1) t-value in factor loading is more than 1.64; and (2) the value of the standardized loading factor ( $\lambda$ ) on each indicator is worth more than 0.5.

Meanwhile, the reliability test is a statistical test performed to determine the consistency of a measurement model by

looking at the value of construct reliability (CR) and variance extracted value (VE). In general, a construct or latent variable is considered to have good reliability if the CR value is greater than 0.70 and the VE value is more than equal to 0.50. However, Hatcher (2013) and Fornell and Larcker in Huang et al. (2013) also believes that a VE value below 0.50 is still acceptable for CR values above 0.60 (Santoso, 2017).

A goodness of fit test is a measure used to evaluate how well measurement models are able to represent data. If the goodness of fit produced by a model is good, then the model is acceptable, and vice versa (Latan, 2012 in Santoso, 2017). According to Hair, et al. (2010), using three to four measures of goodness of fit is considered sufficient to assess the suitability of the model. The tables showing several measures of goodness of fit used in this study can be seen in the Results and Discussion section.

#### Structural Model Analysis

A structural model is a model showing the relationship between latent variables. Through structural model, researchers can see the causal relationship between exogenous latent variables and exogenous latent variables so as to determine whether the research hypothesis is accepted or rejected. The structural model analysis consists of the goodness of fit test and hypothesis test.

The goodness of fit test performed on the structural model is similar to the goodness of fit test on the measurement model, that is to see how the research model is able to produce estimation that represents the data in the field. Meanwhile, a hypothesis test is done to prove the hypotheses that have been determined by the researcher and to see the significance of influence between latent variables. A hypothesis test is done by looking at the values of the following measures:

- t-value  $> \pm 1.64$  with a 5% level of significance, one-tailed (due to the

hypothesized relationships is one-way). The t-value is used to see the effect of latent variables on other latent variables.

- The coefficient of the estimate, where the value indicates the direction of the relationship between latent variables (positive or negative).

### *Descriptive Statistics*

Descriptive statistics are used to describe the basic features of the data in a study. They provide simple summaries about the sample and the measures. In the context of this study, descriptive statistics are used to describe and compare the results of the questions related to the SDGs sectors prioritized to be financed from the *zakah* funds.

## FINDINGS AND DISCUSSIONS

### *Measurement Model Analysis*

#### *Validity Test Result*

The t-value results found that all indicators passed the test except the indicator of the ease of paying *zakah* with current income (PBC4). While the standard loading test results indicate that all statements pass the test except the indicators of routine presence in religious study groups (REL6),

the ease of paying *zakah* with current income (PBC4), the control of *zakah* paying behavior (PBC6), and the interest of paying *zakah* in the future (INT1). After knowing what indicators did not pass the validity test, the next step is the process of dropping by removing the indicators that did not meet the standards of validity. For standard loading and t-value results before and after the process of dropping variables can be seen in the appendix.

#### *Reliability Test Result*

Based on the test results in the table above, the value of the construct reliability of all latent variables has met the criteria of good reliability except for the intention (INT), the value of construct reliability of which reached 0.65. Thus, it can be said that the reliability for intention is weak, but all latent variables of research other than the intention already meet the reliability standards of a research model. Meanwhile, the values of variance extracted of attitude (ATT), trust (TRU), and subjective norm (SN) already meet the criteria of reliability above 0.50. However, Hatcher (2013) and Fornell and Larcker in Huang et al. (2013) argue that a VE value below 0.50 is still acceptable for CR values above 0.60 (Santoso, 2017). Thus, referring to the argument, it can be argued that all the latent variables are reliable.

**Table 2.** Summary of Reliability Test Results of the Measurement Model

	ATT	KNO	REL	TRU	SN	PBC	INT
<b>CR</b>	0.802268	0.788612	0.818434	0.918283	0.863876	0.773544	0.652274
<b>VE</b>	0,509067	0.350427	0.427807	0.692517	0.517832	0.461409	0.486873

#### *Goodness of Fit Test Result*

The next step is to test the goodness of fit in the measurement model. The goodness

of fit test is conducted to evaluate the suitability or suitability of the data with the model.

**Table 3.** The result of the goodness of fit test of the measurement model

<i>The goodness of fit indices</i>	<b>Good Fit Score</b>	<b>Model Score</b>
<i>Root Mean Square Error of Approximation (RMSEA)</i>	RMSEA model $\leq 0.08$	<b>0.079</b>
<i>Incremental Fit Index (IFI)</i>	IFI model $\geq 0.80$	<b>0.83</b>

<i>Comparative Fit Index (CFI)</i>	CFI model $\geq 0.80$	<b>0.83</b>
<i>Normed Chi-Square</i>	$1.0 \leq N Ch^2 \leq 5.0$	<b>2.89</b>
<i>Parsimonious Goodness of Fit Index (PGFI)</i>	$> 0.60$	<b>0.65</b>
<i>Consistent Akaike Information Criterion (CAIC)</i>	The value of the CAIC positive model is closer to the saturated CAIC than CAIC independence	Model CAIC: <b>1990.98</b> Saturated CAIC: <b>3768.25</b> Independence CAIC: <b>6457.34</b>

Based on the results in the table, there are four measures of goodness of fit that indicate the value of good fit and two measures that show the value of marginal fit. According to Hair, et al. (2010), using

three to four measurement indices is sufficient to prove that the model fits. Therefore, it can be said that the measurement model has been able to present the data well.

### Structural Model Analysis

#### Goodness of Fit Test Result

**Table 4.** The result of the goodness of fit test of the structural model

<i>The goodness of fit indices</i>	<b>Good Fit Score</b>	<b>Model Score</b>
<i>Root Mean Square Error of Approximation (RMSEA)</i>	RMSEA model $\leq 0.08$	<b>0.089</b>
<i>Incremental Fit Index (IFI)</i>	IFI model $\geq 0.80$	<b>0.80</b>
<i>Comparative Fit Index (CFI)</i>	CFI model $\geq 0.80$	<b>0.80</b>
<i>Normed Chi-Square</i>	$1.0 \leq N Ch^2 \leq 5.0$	<b>3.38</b>
<i>Parsimonious Goodness of Fit Index (PGFI)</i>	$> 0.60$	<b>0.65</b>
<i>Consistent Akaike Information Criterion (CAIC)</i>	The value of the CAIC positive model is closer to the saturated CAIC than CAIC independence	Model CAIC: <b>2169.48</b> Saturated CAIC: <b>3768.25</b> Independence CAIC: <b>6457.34</b>

Of the six measurements, there are three measurements that have a degree of marginal fit and three measurements that have a good fit degree. According to Hair, et al. (2010), using three to four measurement indices is sufficient to prove that the model fits. Thus, it can be said that the structural model of the study can represent the data well.

#### Hypothesis Test Result

According to Wijanto (2008), the value of the standardized loading factor or the estimated coefficient of  $> 1$  is considered negative and requires respecification. However, based on the results of hypothesis testing, it can be seen that all exogenous latent variables in the research model are able to have a positive and significant influence on endogenous latent variables.

**Table 5.** Summary of the results of the hypothesis test on the structural model

<b>Path</b>	<b>Estimated coefficient</b>	<b>t-value</b>	<b>Conclusion</b>
KNO $\rightarrow$ ATT	0.83	9.20	Positive and significant influence
REL $\rightarrow$ ATT	1.00	13.72	Positive and significant influence
TRU $\rightarrow$ ATT	0.58	9.41	Positive and significant influence
ATT $\rightarrow$ INT	0.79	12.07	Positive and significant influence
SN $\rightarrow$ INT	0.49	6.32	Positive and significant influence

PBC → INT	0.85	11.11	Positive and significant influence
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### *Preferred SDGs Sectors*

Table 6 below summarizes the survey results regarding the respondents' preferences towards the SDGs sectors that could be prioritized from the zakah funds. Based on the results of the data obtained, it is known that respondents placed the

People sector as the main priority sector in achieving the SDGs, followed by the Prosperity sector. The Peace sector is the third priority sector, followed by the Planet sector and the Partnership sector to be the last priority sector chosen by respondents for the achievement of the Goals stated in the SDGs.

**Table 6.** Respondents' Preference to Priority Sectors for Achieving Sustainable Development Goals

Category	Rank	Score	Number of Respondents
<i>People</i> (Eradicating poverty, hunger, healthy and prosperous life, quality education, gender equality, clean water and proper sanitation)	1	1.123	304
<i>Prosperity</i> (Clean and affordable energy, decent work and economic growth, industry, innovation and infrastructure, reducing inequality, sustainable cities and communities)	2	823	304
<i>Peace</i> (Peace, justice and strong institutions for a just, peaceful and inclusive society)	3	687	304
<i>Planet</i> (Consumption and production that are responsible, handling climate change, marine and terrestrial ecosystems)	4	547	304
<i>Partnership</i> (Global partnership to achieve Sustainable Development Goals)	5	480	304

What is interesting from the results of these data is the ranking of the Peace sector on the Planet, indicating that Muslims in Indonesia, represented by respondents, still choose sectors related to social welfare as a priority in achieving development goals. This finding is in accordance with previous findings conducted by the BAZNAS Strategic Study Center in the 2018 Indonesian Zakat Outlook. The BAZNAS Strategic Study Center divides the zakat distribution channel into five main sectors, namely economics, education, da'wah, health, and social humanity. It was found that in 2015, the largest proportion of zakat funds was given to the social humanitarian sector, with a percentage of 41.27 percent of the total zakat funds channeled. The second

field that receives the largest distribution of zakat funds is the education sector with a percentage of 20.35 percent of the total zakat funds channeled. However, in the following year it was found that the education sector became the field with the largest proportion of zakat funding, which amounted to 31.28 percent of the total zakat funds channeled in 2016, followed by the social humanitarian sector with a percentage of 26.51 percent of total zakat funds channeled during the year (BAZNAS Strategic Study Center, 2018). This indicates that the priority of utilizing zakat funds among Muslim communities in Jabodetabek is still focused on sectors that support social welfare, as reflected in the Goals in the People and Prosperity sectors.

## CONCLUSIONS AND RECOMMENDATIONS

This study found three latent variables that influence attitude towards *zakah*, namely knowledge towards *zakah*, religiosity, and trust towards *zakah* institution. This study also found that attitude, subjective norm and perceived behavioral control influence Muslims' intention of paying *zakah*. This also implies that knowledge, religiosity, and trust have an indirect influence towards the intention of paying *zakah*. This is in line with prior research conducted on the influence of the latent variables previously mentioned towards the intention of paying *zakah* (Aji, 2013; Al Jaffri Saad & Haniffa, 2014; Haji-Othman, Alwi, et al., 2017; Haji-Othman, Sheh Yusuff, et al., 2017; Muhammad & Saad, 2016; Nuryana, 2016; Sareye & Haji-Othman, 2017). The findings are also consistent with those reported in previous studies in other fields such as waqf donation and paying taxes (Mohdali & Pope, 2014; Osman, 2014; Rizal & Amin, 2017; Saad, 2014; Shukor et al., 2017). In general, this study confirms the suitability and application of the TPB in the *zakah* context. Variables highlighted in TPB, such as attitudes, subjective norms, and perceived behavioral control and intention, play an important role in explaining the behavior towards paying *zakah*.

The research findings have implications for both theory and practice. Compared to previous research, this study found that subjective norm does not have a very high influence on the intention of paying *zakah*, whereas perceived behavioral control is one of the biggest factors along with attitude. In terms of theoretical implication, the findings indicate that the construct of subjective norms and perceived behavioral control cannot be generalized to all types of environments, objects of research and population.

In terms of practical implications, *zakah* institutions need to put more effort

in encouraging Muslims to pay *zakah* through *zakah* institutions as the majority of Muslims still pay their *zakah* directly to those who are in need (*mustahik*). As religiosity and perceived behavioral control are two factors that mainly influence the intention to pay *zakah*, it is important for *zakah* institutions to promote the value of religiosity and ease of access to the *zakah* payers. By promoting the importance of paying *zakah* as it is an obligatory act in Islam, and the easiness of paying through *zakah* institutions, the Muslim public can be more convinced that paying *zakah* through *zakah* institutions bring more benefit than harm for both the *zakah* payers and the *zakah* recipients. *Zakah* institutions should also focus on increasing communication between the *amil* (*zakah* collectors) and the *zakah* payers. This can help increase the Muslim public's awareness towards paying *zakah* and their intention to do so.

Furthermore, based on estimates made in the study, zakat funds are also found to have the potential to support the achievement of SDGs in Indonesia. Of the five priority sectors, the majority preference for muzakki in Jabodetabek falls to the People sector, which includes alleviating poverty and hunger, healthy and prosperous life, quality education, gender equality, clean water and proper sanitation. This indicates that the priority of the Muslim community in Jabodetabek is still in the social sphere of humanity, including poverty alleviation, realizing social welfare, good education and decent water and sanitation facilities for all. The second priority sector that becomes the muzakki preference in Jabodetabek for the contribution of zakat funds is the Prosperity sector (clean and affordable energy, decent work and economic growth, industry, innovation and infrastructure, reducing inequality, cities and sustainable communities). The third priority preference is Planet (responsible consumption and production, handling climate change, terrestrial and marine

ecosystems), followed by Partnership (international partnerships to reach SDGs), and the last priority sector is Peace (peace, justice and strong institutions for a just, peaceful and inclusive society). The findings highlight the potential of *zakah* in supporting achievement of SDGs in Indonesia, something that might be useful for government, NGOs, *zakah* organizations and other *zakah* stakeholders.

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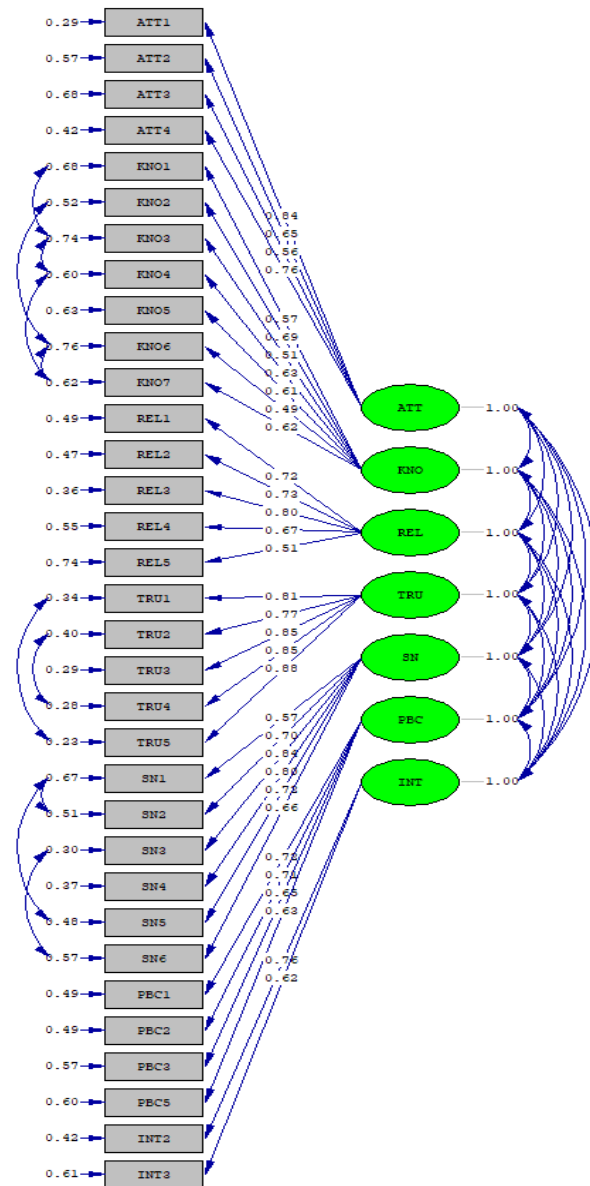
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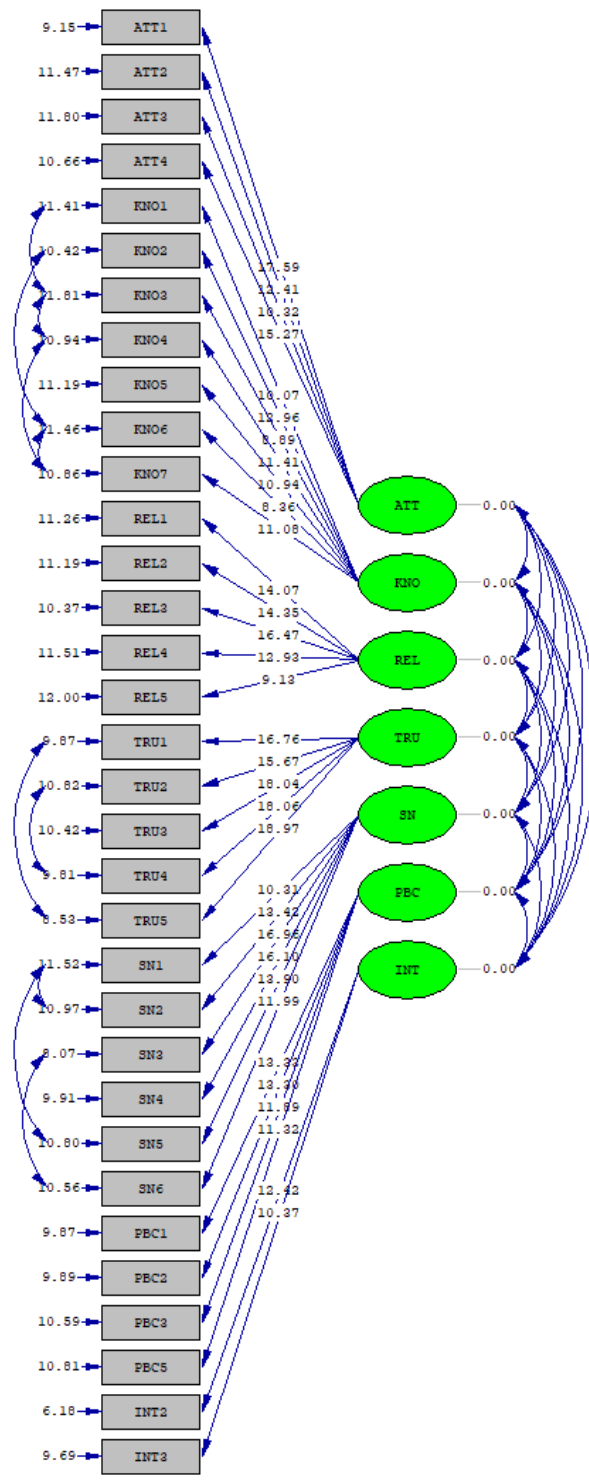
## APPENDICES

## Appendix A – Path diagrams of the measurement model



Chi-Square=1339.43, df=464, P-value=0.00000, RMSEA=0.079

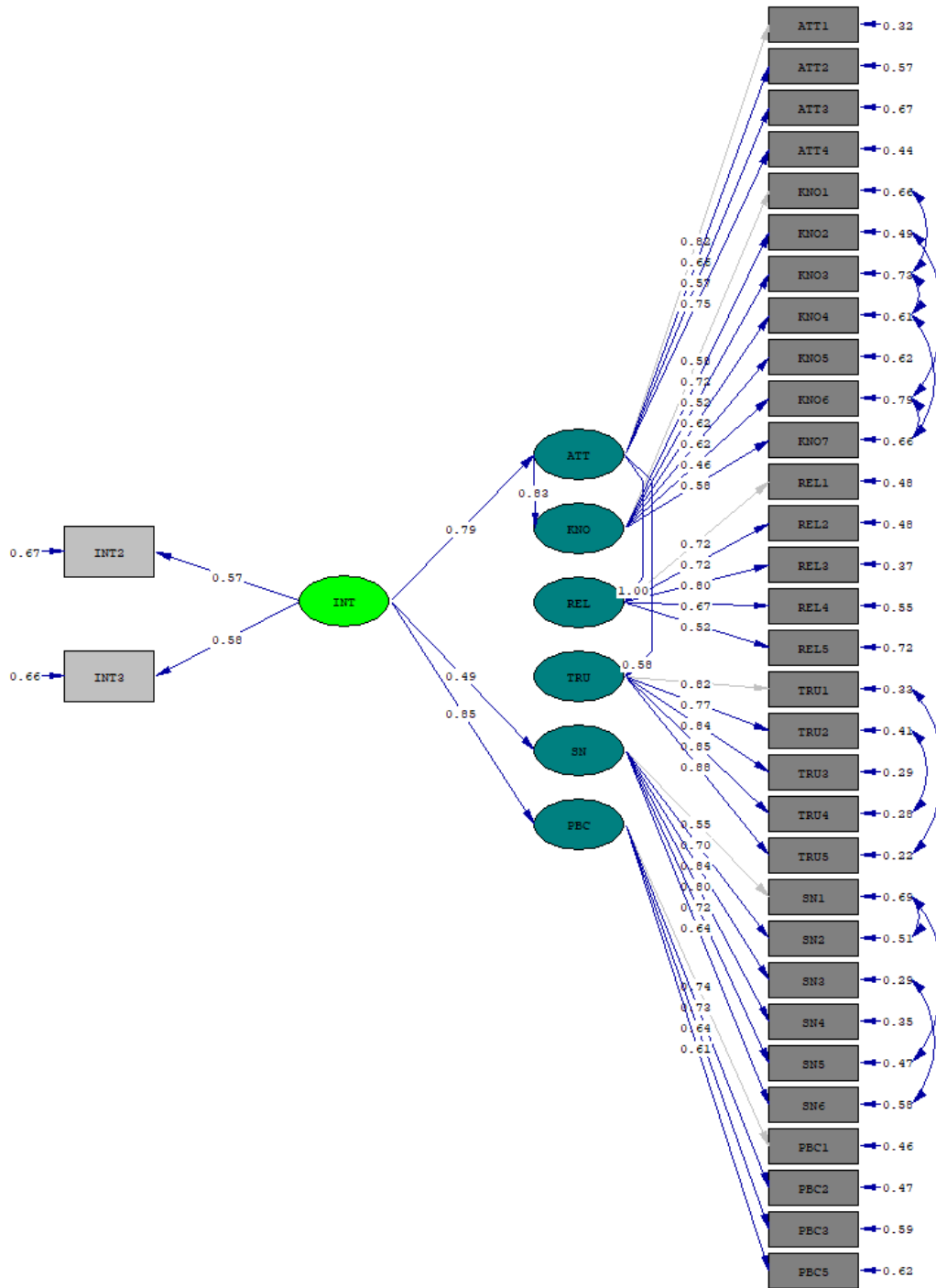
(a) standardized solution values of the measurement model



Chi-Square=1339.43, df=464, P-value=0.00000, RMSEA=0.079

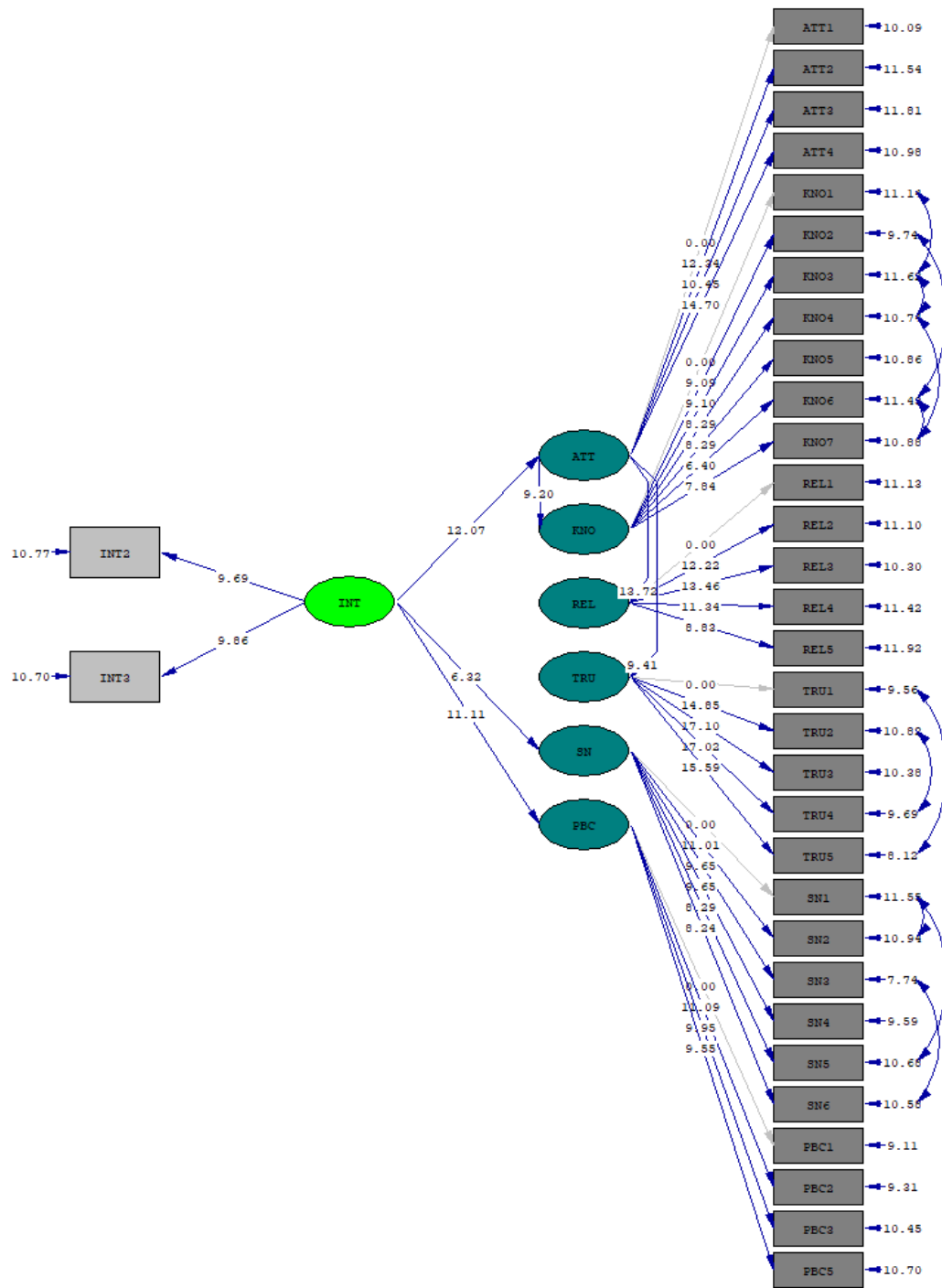
(b) t-statistics values of the measurement model

Appendix B – Path diagrams of the structural model



Chi-Square=1618.69, df=479, P-value=0.00000, RMSEA=0.089

(a) standardized solution values of the structural model



Chi-Square=1618.69, df=479, P-value=0.00000, RMSEA=0.089

(b) t-statistics values of the structural model



## A Review on Zakat Payments by Islamic Banks in Malaysia

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### ABSTRACT

*Zakat plays an important role in the economic development of the ummah. In line with Shariah requirements, the responsibility of paying zakat does not only lie in the Muslim individuals but also businesses, specifically Islamic banks. Islamic Banks exist to fulfil the financial (economic) needs of Muslims within the confines of the Islamic faith. This study aims to analyse the payment of zakat made by the Islamic Banks in Malaysia by firstly, examining the various methods adopted by the Islamic banks and secondly, comparing the existing method of zakat computation. A total of 16 Islamic banks are selected and the financial statements are reviewed from the year 2013 till 2017. The results of the study show that most of the Islamic banks adopted the two methods recommended by JAKIM and both methods show similar results. The results also show an underpayment of zakat by the selected Islamic bank. Further the study found that the detail computation of zakat is not disclosed in the financial statements and hence the study could not identify the adjustments for the zakat computation for all the Islamic banks.*

*Keywords: Zakat, Islamic Banks, Shariah, Method*

### INTRODUCTION

Zakat is one of the five pillars of Islam but there are Muslims today who failed to adhere to this pillar of Islam (zakat). Islamic Law stipulates that zakat should be used to help and support the poor and the needy, to free slaves and debtors, for the cause of Allah and for the musafir as mentioned specifically in Surah At Tawbah Verse 60. As a Muslim, we are required to know how to compute and pay zakat but many Muslims today do not know how to compute zakat properly. This has led to some Muslim underpaying zakat and some who did not pay at all. This matter is of grave concern as the religion has put great emphasis in helping the ummah – the poor and needy. Islam emphasize the need to have an equitable, fair and compassionate ummah.

In achieving this objective of having an equitable, fair and compassionate ummah, the responsibility

to pay zakat lies not only on Muslim individuals but also to businesses. One of the most important economic activity encouraged by the prophet Rasulullah (PBUH) is business. Business activity is a one the ways to accumulate wealth and it is subjected to zakat. Various verses from the Quran stressed the necessity for businesses to pay zakat. Among the verses are Surah Al Baqarah Verse 276 and Surah At Tawbah Verse 103. Jawhar (2009) stressed that all kinds of businesses involving goods or services that fulfil the requirements is subject to zakat. Thus zakat is one of the important source of funds to a country's economy.

Further, Abdul Rahman and Awang (2003) state that paying zakat on one's business wealth is based on the Islamic concept of wealth being bestowed by Allah, the real owner of all wealth, as a trust. In addition, the researchers stressed zakat is essential as a social welfare levy imposed to Islamic society's wealthier

members and more prosperous businesses and thus helps to close the gap between the poor and the rich. Hence, the business that the study is going to analyse is the Islamic banks from the perspective of zakat being paid by these institutions.

According to Ismail, Tohirin and Ahmad (2013), business entities such as Islamic banks are considered as a vehicle to create value added or the wealth of individual. In addition, Ebrahim and Joo (2001) have identified one of the goals of Islamic banks is to foster the growth of the economy of the Muslim by developing financial market, institutions and instruments. In tandem with the above, AIBIM also highlighted that one of the goals of Islamic banks is for equitable distribution of income and wealth. The justification by the above literatures proved that the Islamic banks is the right vehicle to achieve those goals. These goals can be achieved through the payment of zakat by these institutions.

Zakat, therefore, plays an important role in the economic development of the ummah. Islamic banks in Malaysia are required to pay zakat in line with Shariah requirements. As payment of zakat is a requirement to be fulfilled, there are various methods of zakat computation approved by the Majlis Fatwa of the country and hence, this study aims to examine the various methods adopted and the amount of zakat payment made by these Islamic banks. Therefore, the objective of this study is to analyse the payment of zakat made by the Islamic Banks in Malaysia that is to examine the various method adopted by the Islamic banks and to compare the existing method of zakat computation. The study hopes to shed some light on the differences of amount (if any), and whether there is underpaying of zakat payments by these Islamic banks if different methods are adopted by them.

## LITERATURE REVIEW

AAOIFI's FAS 9 define zakat as blessings, purification, increase and cultivation of good deeds. It is called zakat because it blesses the wealth from which it is paid and protected. In Shariah, zakat is an obligation in respect of funds paid for specified type of purpose and for specified categories. Basically, there are two types of zakat, namely zakat on wealth (zakat mal) and zakat on self (zakat fitr). Zakat on self is obliged to all Muslims who live in the whole year of Hijra until the end of Ramadan of that particular year. It is paid in the month of Ramadan before the celebration of Eidul Fitr (1 Syawal). The types of wealth on which zakat must be paid are in the form of monetary wealth in business and employment income, savings, shares, gold, employee provident funds, crops and livestock. Zakat is only obligatory on property possessed for at least one lunar year, though if during the year while the value of the property exceeds the nisab and more property which is held for less than one year is added to the original amount, zakat is paid on the new amount (i.e. zakat is paid on the original property held for one year plus new property held for less than one year, <https://www.ethicainstitute.com>, (2013). The zakatable wealth should exceed the exemption limit (nisab). Thus, the wealth is zakatable at the rate of 2.5%.

Zakat is an obligatory act to all Muslim because it is one of the five pertinent pillars of Islam. Whoever claims that Zakat is not obligatory and refuses to pay it, is not a Muslim, but a Muslim who refuses to pay Zakat due to stinginess, while affirming its obligation, has committed a great sin for which one will be severely punished. Thus, when a person is liable to pay zakat, a certain percentage of his wealth should be distributed immediately in the correct manner to the poor as stated in the al Quran and Hadis. Thus, those with a certain level of accumulated wealth (nisab & haul) are

obligated to pay zakat to purify themselves from the sins of greed (Awang & Mokhtar, 2011; Sarea & Hanefah, 2013).

#### *Business zakat in Islamic Banks*

All Muslims are required to pay zakat. Licensed Islamic banks or any banks embedded the word Islam are enmeshed with the obligatory act to pay zakat. In fact, business zakat is obligatory for all types of businesses - be it sole proprietorship, limited partnerships or public companies - so long as Muslims have interests in them (Ismail, Tohirin & Ahmad, 2013). In fact, zakat is due on anything purchased with the intention of reselling the item, <https://www.ethicainstitute.com>, (2013). It was further mentioned that tradable goods are zakatable at all stages of production, regardless of whether they are raw material, work in progress or finished product. However, according to Sulaiman (2016), the Islamic bank is an artificial entity. Thus, Islamic banks need not pay zakat. However, Islamic banks are obliged to pay zakat when the law requires the bank to satisfy the zakat obligation, when they are required by their charter or by-laws to satisfy the zakat obligations and when the general assembly of shareholders has passed a resolution requiring Islamic banks to satisfy the zakat obligation.

The basis of computation of zakatable amount slightly differ from one type of zakat to another. Business zakat accounting is established on the basis of ijtihad as agreed by all scholars (Hamat, 2009). AAOIFI's FAS 9 revealed that for business zakat it is obligatory on accounts receivable which are acknowledged by debtors who are able to pay them. It is also obligatory if the debtors refuse to acknowledge the account receivable but there is evidence that they are due and collectible. The standards specify two methods that are net assets method and net invested funds method. Review done by Sarea & Hanefah, 2013 revealed that

AAOIFI has no authority to impose its standards to be adopted by Islamic Banks, its standards therefore remain voluntary in some countries such as Malaysia. Central Bank of Malaysia (BNM) has no objection to the adoption of the AAOIFI standards but not in contradiction to the national requirements. Basically, there are no specific requirements for the financial statements to show movement of zakat as required by the AAOIFI Zakah FAS 9 standard in Malaysia.

In 2001, the Department of Islamic Development Malaysia (JAKIM) has published a book entitled "Panduan Zakat di Malaysia". According to this book, there are two highly recommended methods of business zakat to be applied. The first method is urfiyyah. This method is also known as the adjusted growth capital which considers the equity of ownership in a particular company and other financial sources. The second method is the syariyyah method. This method is also called the adjusted working capital.

The practice of business zakat measurement in Malaysia involves several methods (Hamat, 2009). The most common methods are Growth Capital Method and Working Capital Method (Awang & Mokhtar, 2011). According to Mohamed Abdul Wahab et al. (1995), there are three methods of business zakat accounting which are being practiced in various states and institutions in Malaysia, which are the current assets method, current asset and profit from investments method and net working capital method. The latter method was later adopted by Bank Islam Malaysia Berhad (Hamat, 2009). AAOIFI FAS 9 states that zakat is not due on fixed assets (e.g. property, plant and equipment). Business zakat accounting practiced by such institutions can be divided into three methods. First, zakat applies only to current assets as practiced in the state of Kedah, Johor and Kelantan. Secondly, zakat is imposed on the working capital assets as practiced in Perlis. Finally, zakat is imposed on the adjusted

working capital as practiced in states other than the states of Kedah, Johor, Kelantan and Perlis. However, at this point in time, all states in Malaysia impose zakat on the adjusted working capital (Hamat, 2014).

In so far, the detail information to assess zakat is not properly disclosed in the financial statements especially among the Islamic banks in Malaysia. The uniform and transparent method of zakat payment plays an important role as a benchmark to other institutions while becoming a fiscal distribution mechanism for social assistance to grant better education, health care, housing, and public transportation for Muslims in a welfare state and creates a balanced growth cycle (Yusuf, 2013). The most crucial aspect to look into is determining the zakatable items/assets, the method to select the basis of zakat and the formula of zakat calculation, within an Islamic bank entity. From practices exposed in this paper, only in a few countries, such as Bahrain, United Arab Emirates and Malaysia implemented business zakat in Islamic banks. In the first two countries, zakatable items are clearly mentioned, i.e. the banks' reserve, and retained earnings, while for Malaysia, no specific items are explicitly mentioned (Sarea & Hanifah, 2013). Further, a study by Ismail, Tohirin & Ahmad (2013) revealed that among Islamic banks in Malaysia, it is unclear from which zakatable items the calculated zakat be applied. Among other problems arising in implementing business zakat are its chargeability and its calculation, determination of zakat base and zakat eligibility of assets and liabilities.

Study by Hamat (2009) found that all zakat scholars in Malaysia agreed that adjusted working capital should be the method to be used, however, other methods cannot be denied. In addition, they expressed the same opinion that business zakat accounting method should not be rigid, therefore, it could be changed according to the requirement of the current situation. Ultimately, zakat is payable on

the business income irrespective of whether profit has been earned or not. Even for businesses that suffer losses but still has a positive working capital, zakat is still payable.

## METHODOLOGY OF STUDY

The population of our study consists of Islamic Banks operating in Malaysia. Our sample was based on the list of Islamic financial institutions from the Bank Negara Malaysia (BNM) List of Licensed Islamic Financial Institutions in Malaysia and there are 16 such institutions in the country. Among the 16 institutions, 11 banks are locally incorporated and they are Bank Islam, Maybank Islamic, Ambank Islamic, Bank Muamalat, Affin Islamic, Alliance Islamic, CIMB Islamic, Public Islamic, RHB Islamic and Hong Leong Islamic and MBSB Bank. The five foreign banks are Standard Chartered Saadiq, Kuwait Finance, OCBC Al-Amin, HSBC Amanah and Al Rajhi Bank.

These study encompasses the examination of specific financial statements and a content analysis of specific reports in the published annual reports of these Islamic banks for the years 2013 until 2017. The period of 2013 to 2017 was chosen as the Financial Services Act (FSA) and the Islamic Financial Services Act (IFSA) came into force on 30 June 2013 replacing the repealed Islamic Banking Act 1983 (IBA). From the total number of 16 Islamic Banks, data was only collected from 15 banks as the financial statements of Ambank Islamic for the years of 2013, 2014 and 2017 were not accessible through its website. In examining these Islamic banks, two specific statements were reviewed and they were the Statement of Financial Position and Statement of Income.

According to Hamat, 2009, the measurement of business zakat is based on the data from the statement of financial position. Awang and Abdul Rahman

(2003) in their study on zakat measurement highlighted two approaches namely the Growth Model method and the Working capital model. The Growth

Model method also known as Adjusted Growth Capital method considers the equity of ownership. The formula is as below:

$$\text{Equity} + \text{Long term equity} - \text{Fixed Asset} - \text{Non Current Asset} +/- \text{Adjustments.}$$

The latter approach namely the Working Capital Model considers current assets by deducting currents liabilities and

taking into account the necessary adjustments (Hamat, 2009). The formula is as below:

$$\text{Current Asset} - \text{Current Liabilities} +/- \text{Adjustments}$$

For the collection of the above data, the Statement of Financial position is examined. Items in the financial statements collected are:

**Statement of Financial Position**

- 1 Total Assets
- 2 Fixed Assets (Property, Plant and Equipment)
- 3 Total Liabilities
- 4 Share Capital
- 5 Reserves/Share Premium/Retained Profits/Other Reserves
- 6 Total Equity

Additionally, the Income Statement of these Islamic Banks were reviewed for purposes of collecting the data on Net Profit before Tax and Zakat and the Zakat.

**Statement of Income**

- 1 Profit before Tax and Zakat
- 2 Zakat

Apart from the above, a content analysis was carried out by examining

firstly, the Shariah Committee Report in the Annual Reports of these Islamic banks to identify the policy adopted by these banks as to the specific approach taken of either the Growth Model or Working Capital Model. Secondly, the Notes to the Financial Statements specifically on the Summary of Significant Accounting Policies were examined to identify further information on zakat payment and computation. Content analysis has been widely employed in prior studies to measure voluntary and mandatory disclosures in annual reports (e.g. Hackston & Milne, 1996; O'Donovan, 2002; Clemens & Douglas et al., 2006).

**RESULTS AND ANALYSIS**

The Shariah Committee Report of the Islamic Banks were scrutinized and various statements on Zakat and Zakat obligations were gathered. Examples of the excerpts from the Shariah Committee reports are as below:

**Table 1.** Summary of Excerpt from the Shariah Committee Report

<i>The bank pays zakat on its business. The banks does not pay zakat on behalf of the shareholders and depositors.-Alliance Islamic</i>
<i>In the financial year under review, pursuant to the Bank's Zakat Policy, the Bank has fulfilled its obligation to pay zakat on its business to the federal zakat body and other eligible recipients selected by the Bank and the zakat is computed using growth capital method. The zakat body had refunded a portion of the zakat paid and had appointed the Bank to act as their agent (wakeel) to</i>

<i>distribute to eligible beneficiaries (asnaf) on behalf of the zakat body. – Bank Muamalat</i>
<i>The calculation of zakat is in compliance with Shariah principles. The zakat fund is distributed through various channels i.e. States Zakat Collection Centre, non-governmental organization and individuals under asnaf categories of poor, needy, amil, riqab, gharimin and fisabilillah.- Affin Islamic</i>
<i>All earnings that have been realised from sources or by means prohibited by the Shariah principles that we discovered have been considered for disposal to charitable causes. – Al-Rajhi Bank</i>
<i>In the financial year, the Bank has made a zakat payment on its business to state zakat authorities and the zakat is computed using the growth capital method. The beneficiaries of the zakat fund were Lembaga Zakat Selangor, International Islamic University Malaysia (IIUM) Endowment Fund, Lembaga Zakat Kedah, Universiti Teknologi Mara (UiTM) Zakat Centre and Pertubuhan Kebajikan Islam Malaysia (PERKIM). – OCBC Al Amin</i>
<i>The financial statements of the bank for the year ended ..... together with the calculation of zakat disclosed to us are in compliance with the shariah rules and priciples. – Maybank Islamic</i>
<i>The Bank does not pay zakat on behalf of the shareholders or depositors- Standard Chartered Saadiq</i>
<i>Standard Chartered Saadiq Berhad during the year ended 31 December 2017 is not required to pay zakat because its shareholder is non-Muslim.</i>
<i>The Bank is not required to pay zakat for the financial year ended 31 December 2017 because its shareholder has no obligation to pay zakat. – HSBC Amanah</i>

Based on the examination of the audited financial statements of the Islamic banks, the study found that there are other methods adopted instead of the two commonly mentioned methods (Growth Asset Method and Net Assets Method) advocated by the Shariah scholar as follows:

**Table 2.** List of Islamic Banks and Method Adopted by the Banks

<b>No</b>	<b>Islamic Banks</b>	<b>*Majority ownership</b>	<b>Zakat Methods Adopted</b>
<b>1</b>	Affin Islamic Bank Bhd	Government owned	Net Assets Method
<b>2</b>	Al Rajhi Banking & Investment Corporation (Malaysia)	Foreign bank	Paid by parent company
<b>3</b>	Alliance Islamic Bank Bhd	Foreign Bank	Growth capital method.
<b>4</b>	AmBank Islamic Bhd	Government & Family Owned	Financial statement not available
<b>5</b>	Bank Islam Malaysia Bhd	Government	Growth capital method
<b>6</b>	Bank Muamalat Malaysia	Government & Individual	Shareholders' funds growth

	Bhd		method
7	CIMB Islamic Bank Bhd	Government	Average growth method
8	HSBC Amanah Malaysia Bhd	Foreign	No zakat payment made due to no muslim equity muslim.
9	Hong Leong Islamic Bank Bhd	Family owned	Net assets method
10	Kuwait Finance House Malaysia Bhd	Foreign	Paid by parent company
11	MBSB Bank Bhd	Government	Method not disclosed in the financial statement
12	Maybank Islamic Bhd	Government	Average growth method
13	OCBC Al Amin Bank Bhd	Foreign	Growth capital method (zakat paid based on Muslim equity portion)
14	Public Islamic Bank Bhd	Family owned	Profit and loss method
15	RHB IslamicBank Bhd	Government	Working capital method
16	Standard Chartered Saadiq Bhd	Foreign	No zakat payment made due to no muslim equity muslim.

\*M Abbas (2012)

The other methods adopted include the Profit Loss Method, Average Growth Method and Shareholders' Funds Growth Method. The Islamic banks that adopted the different methods were Bank Mualamat (Shareholders' Funds Growth Method), CIMB Islamic Bank (Average Growth Method), Maybank Islamic (Average growth method) and Public Islamic Bank. There are two foreign banks namely Al Rajhi and Kuwait Finance House that their zakat was been paid by their parent company.

A Foreign controlled bank namely OCBC Al Amin pay zakat based on the Muslim equity of the bank. While another two foreign banks did not pay zakat since the owners are non-muslim and this in line with the Ijma of the Shariah Scholar (Mohamad and Trakic, 2013). There is only one Islamic bank –MBSB Bank Bhd did not mention the method of zakat payment that the bank adopted. Thus based of these findings most of the Islamic banks adopted two highly recommended methods by JAKIM on business zakat that is urfiyyah method or is also known as the adjusted growth capital method which considers the equity of ownership in a

particular company and other financial sources. While the second method is the syariyyah method or adjusted working capital method that considers current assets and deducts current liabilities.

This study managed to compute the zakat made by Bank Islam for the five-years period from 2013 until 2017 based on the most complete data available. Most of the Islamic banks' published data are not readily available. Furthermore, most of the Islamic banks are not listed entities. Based on the reviewing of the financial statements of the Islamic banks we found that the detail information to derive at the adjustments amount using Growth Capital method is not available in the financial statement nor in the notes to the accounts. The figures for some of the adjustments are only mentioned in the corporate information and the bank activities during the year but there was no conclusive statement that the figures are the total amount for each of the adjustment items.

Moreover, none of the Islamic banks disclosed the details computation in arriving to the amount of zakat that they paid. Unlike tax, all information is disclosed specifically in the notes to the

accounts. Thus, due unavailability of these information, we decide to exclude adjustments in our computation. Although, we exclude the adjustments, the above analysis revealed slightly the same result when using both methods. This is consistent with the study conducted by Hamat (2009), whereby both methods resulted into insignificant differences in arriving at the zakat amount. The computation of these differences is shown in Table 3.

Based on the result from Table 3, the study found that the zakat payment made by the bank is significantly lower as compared to the calculation done by this study based on the two alternative methods proposed by scholars that are growth capital method and working capital method. The percentage of the differences range significantly between 384% - 759% which is lower than the actual zakat paid, with the amount ranging between RM48,997 – RM100,104 for the two methods. This computation excluded adjustments due to insufficient details information required as mentioned above. AAOIFI's FAS 9 specified two methods that are net assets method and net invested funds method. Even if the simple net assets method was used, the minimum zakat payment should be RM61,744 instead of RM12,747.

**Table 3: Zakat Computation for Bank Islam using Growth Method and Working Capital Method**

ZAKAT METHOD	2013	2014	2015	2016	2017
	RM'000				
Zakat amount (Published)	12,568	12,747	8,703	12,851	13,323
<b>Growth Method:</b>					
1. Net Worth of Current Assets	3,313,896	2,469,768	2,989,132	3,622,206	4,409,323
2. Adjustments	-	-	-	-	127,755
Total	3,313,896	2,469,768	2,989,132	3,622,206	4,537,078
Zakat based on CG Method:	<b>82,847</b>	<b>61,744</b>	<b>74,728</b>	<b>90,555</b>	<b>113,427</b>
<b>Percentage of Difference for Zakat (Actual Versus CG Method)</b>	<b>559%</b>	<b>384%</b>	<b>759%</b>	<b>605%</b>	<b>751%</b>
<b>Working Capital Method:</b>					
1. Current Assets	41,277,513	44,236,020	47,916,853	54,059,975	56,118,903
2. Current Liabilities	37,963,617	41,766,252	44,927,721	50,451,864	51,709,580
Net worth of Current Assets	3,313,896	2,469,768	2,989,132	3,608,111	4,409,323
Zakat based on WC Method:	<b>82,847</b>	<b>61,744</b>	<b>74,728</b>	<b>90,203</b>	<b>110,233</b>
<b>Percentage of Difference for Zakat (Actual Versus WC Method)</b>	<b>559%</b>	<b>384%</b>	<b>759%</b>	<b>602%</b>	<b>727%</b>

## CONCLUSION

From the 16 Islamic banks, twelve Islamic banks paid zakat and more than half of these banks (eight banks) adopted the recommended method by JAKIM namely the urfiyyah method or also known as the adjusted growth capital method and the syariyyah method or adjusted working capital method. While another four of the Islamic banks adopted other methods approved by their Shariah Committee. Secondly the study found that the zakat payment made by the bank is significantly lower as compared to the calculation done by this study based on the two recommended methods stated above. In analysing the zakat payment in the financial statement, the study also found that all the Islamic banks did not disclose the detail computation in arriving to the zakat payment. This practice is totally in contract with the tax computation that is detailed out in the financial statement specifically in the notes of the account.

### *Recommendations*

This study raises several suggestions to Islamic banks for further considerations. Firstly, it is recommended that the Islamic banks should disclose the details computation of zakat in the notes of account of the banks for transparency and easy retrieval to recompute the zakat payment. This is important to for the regulators, financial analyst and others to check and balance the zakat disclosed in the financial statements. Further, the Islamic banks should pay more zakat (by not taking into accounts some of the adjustments) in order to meet their objective of Maslahah of ummah namely as socio-economic justice and equitable distribution and last but not least the Islamic banks should be given the privileged to opt in paying zakat instead of tax in order to meet their objective of Maslahah of ummah namely as socio-

economic justice and equitable distribution.

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