

## **ZAKAH AS DEDUCTIBLE FOR TAXABLE INCOME: A MACROECONOMIC PERSPECTIVE**

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### **Abstract**

*Zakah is a very basal religious service and closely interconnected with both transcendental and social aspects of human life. According to Islamic rules, zakah is imposed on every soul (zakah al-fitr) and certain properties meeting the standardized measure (zakah al-maal). Collected zakah is hereinafter distributed to the poor, the needy, the people employed to administer zakah, and the people whose hearts are made to embrace Islam, the people in bondage, the people twined by debt, the fighters in the cause of Allah, as well as the wayfarers. In Zakah Management Act No. 38/1999 mentioned, that zakah which have been bestowed to Badan Amil Zakah or Lembaga Amil Zakah (i.e. government and non-government bodies for the collection of zakah respectively) will be considered as deductible for one's taxable profits or incomes. Likewise, in Act No. 17/2000 contended that zakah of income can be considered as deductible for one's taxable incomes. With a few appropriate assumptions, we can prove that the application of zakah as deductible for one's taxable incomes will have several impacts on the economy. Aggregate consumption will increase, saving will decrease, investment criterion will change, and national income as a whole will finally enlarge. Government is therefore suggested not to hesitate to execute the Zakah Consciousness Movement.*

### **INTRODUCTION**

Quantitatively, Indonesia is a state with the biggest Moslem population in the world. Of more than 200 million Indonesian residents, about 80% are confessing to believe in Islam. However, it does not mean that Indonesia is an Islamic state. Refers to its constitution, Indonesia is a secular state which dissociating positive laws from the religious ones.

The enactment of Act No. 38/1999 concerning *Zakah* Management and Act No. 17/2000 concerning the Third Change of Act No. 7/1983 on Income Tax brings about a fine opportunity for Indonesian Moslems. With such codes, Moslems' payment of *zakah* will be harmonized with their payment of tax. Moreover, in December 2001, President Megawati Sukarnoputri has delivered officially the *Zakah* Consciousness Movement at national level.

Many doubts however still emerge. Not only referred to Act No. 38/1999 and Act No. 17/2000 that is far from ideal, and or *zakah* administrators' experience that is limited, but the worst is that government itself impresses acrophobia and hesitation in the execution of the program.

One possible factor responsible for such a hesitation is government's anxiety that the application of *zakah* as deductible for taxable income will complicate the effort to increase government's revenues in national budget (APBN). Targeted revenues cannot be met, and consequently, economic recovery process will be annoyed.

This paper discusses issues related to the application of *zakah* as deductible for taxable income. This discussion includes the impacts of *zakah* and taxation policy on Indonesian economy: aggregate consumption, saving, and investment, as well as national income.

## THE IMPORTANCE OF ZAKAH

*Zakah* is the definite proportion of certain property must be bestowed by every Moslem and later be passed to the eight channels according to Islamic teaching. The obligation to pay *zakah* is fundamental, and closely interconnected with transcendental and social aspects of life.

These transcendental aspects can be traced from the number of verses in the *Quran* concerning *zakah*, including among others 27 verses that relating the obligation to pay *zakah* and the obligation to perform prayers (*shalah*) in a series.<sup>1</sup> Muhammad the Messenger even places the payment of *zakah* as one of the five pillars which uphold Islam.<sup>2</sup>

Likewise, starting from the principle of *al-'adalah al-ijtima'iyah* (social justice), the command of *zakah* can be comprehend as one indivisible system in the attainment of socio-economic welfare (Doa, 2001). Bestowed *zakah* will further be passed to the eight channels, including the poor, the needy, the people employed to administer *zakah*, and the people whose hearts are made to embrace Islam, the people in bondage, the people twined by debt, the fighters in the cause of Allah, as well as the wayfarers. All of them show various forms of social security in Moslem society.<sup>3</sup>

Mannan (1997) considers *zakah* as a religious-economic activity with five important elements. First, religious belief, meaning that every Moslem paying *zakah* consid-

ers his action as an implementation of belief and adherence. Second, redistribution and justice represent the function of *zakah* as a way to redistribute properties. Third, maturity and productivity, i.e. the emphasis that payment time passes one year – a normal measure for human being to earn income. Fourth, freedom and reason, meaning that the obligation of *zakah* only apply for individuals having sound of body and sound of soul. Fifth, ethics and fittingness, means that *zakah* is levied properly, without leaving burden exactly complicates *muzaki*.

## THE RULES OF ZAKAH

According to Islamic teaching, *zakah* is imposed on every soul (*an-nafs*) and certain properties meeting the standardized measures (*al-maal*).

*Zakah* imposed on every soul is *zakah al-fitr*, which is paid once a year in the month of *Ramadhan*.<sup>4</sup> *Zakah al-fitr* is bestowed in the form of one *sa'* of foodstuffs such as rice, wheat, soybeans, or *sorghum*.<sup>5</sup> Or, referring to portions of Moslem scholars, *zakah al-fitr* can also be bestowed in the form of cash equivalent to the price of one *sa'* of the above foodstuffs.<sup>6</sup>

*Zakah* imposed on properties is *zakah al-maal*, which is paid once in a more flexible time throughout the year. In general, properties that must be imposed *zakah* are those in full possession (*al-mikuttam*), and the owner is free from the obligation to pay debt. The properties should also exceed one's own basic needs (*al-hajatul ashliyah*),

<sup>1</sup> The word *zakah* as a definition (*ma'rifah*) is stated 30 times in the *Quran*, of which 27 times is mentioned in a series with the obligation to perform the five prayers. See, among others, *al-Baqarah* 2:83,110; *an-Nisaa'* 4:77; *at-Taubah* 9:5,11,18,71; *Maryam* 19:31,55; *al-Anbiyaa'* 21:73; *al-Hajj* 22:41; *an-Nuur* 24:55-56; *an-Naml* 27:3; and *Luqman* 31:4.

<sup>2</sup> "Islam signifies that you worship Allah and do not associate anything with Him and you perform the prescribed Prayer and you pay the obligatory poor-due (*zakah*) and you observe the Fast of Ramadan." (Bukhary and Muslim)

<sup>3</sup> *At-Taubah* 9:60.

<sup>4</sup> The Messenger of Allah ordered that the Charity of *al-Fitr* should be paid before the people go out for the (*Eid*) Prayer. (Bukhary and Muslim from Ibnu Umar).

<sup>5</sup> Allah's Messenger prescribed the payment of *zakah al-fitr* (on breaking the fast) of Ramadhan one *sa'* of barley Abu Daud and Nasa'i from Hasan).

<sup>6</sup> Moslem scholars have different opinions on this matter. Imam Abu Hanifah, at-Tsuri and Abu Yusuf give permission, whereas, Imam Malik and Syafi'i not. See, Qardhawi (1993, 954-957).

fulfilling minimum amount liable to zakah (*nisab*), and have potency to grow, as well as lapse a full year (Sartini, 2001).

The objects of *zakah al-maal* consist of: First, cattle and other animals, including big animals such as camel, ox, or buffalo, and small animals such as sheep or goat.<sup>7</sup> Camel reaches its *nisab* after five, buffalo or ox after 30, and goat after 40. Each animal has different *zakah* rate, which irregularly changing along the accretion of its amount.

Second, crops and fruits, including durable products used both for food and not-for-food, measurable and immeasurable (with heavy measuring).<sup>8</sup> Paddy, maize, grist, barley, almonds, shallot, garlic and other measurable goods including all kind of fruits are liable to *zakah* when reaching five *wasq*,<sup>9</sup> whereas cotton, *zaifran*, and other goods immeasurable in *wasq* are liable to *zakah* when their price equivalents with the actual price of the cheapest measurable goods.<sup>10</sup>

Prophet Muhammad, in his letter addressed to Mu'adah Bin Jabal in Yemen, states that the level of *zakah* for the crops and fruits are determined based on farm characteristics. When the crops and fruits are obtained from farms irrigated with natural

water (i.e. rain or river water), the amount of *zakah* is one-tenth or 10%. When the crops and fruits are obtained from farms irrigated with costly method of irrigation, such as digging a well and bringing up the water mechanically, the amount of *zakah* is half one-tenth or 5%.<sup>11</sup>

Third, *rikaz* or the found goods. This includes those buried in the earth such as liquid and solid mining goods.<sup>12</sup> *Rikaz*, when reaching its *nisab*, is liable to *zakah* at the rate of 20%<sup>13</sup> without having to wait until one-year deadline.<sup>14</sup>

Fourth, silver and gold, or money and other financial deposits equivalent to silver's or gold's price.<sup>15</sup> Silver and gold are liable to *zakah* when reaching their *nisab*, i.e. 200 *dirhams* and 20 *dinars*<sup>16</sup> respectively (about

<sup>7</sup> Here, there is an exception for animal used for work. Muhammad the Messenger is reported to have said, "There is zakah on animals used for work and carrying burden". (Abu Abbas).

<sup>8</sup> This is contention of Imam Abu Yusuf. A slight different position stated by Imam Abu Hanifa who mentions all kind of agricultural products and Imam Syafi'i who mentions only durable products used for food. See, Afzalurrahman (1996, 267-273).

<sup>9</sup> This is taken from the opinion of Imam Abu Hanifa who mentions that all kind of agricultural products is liable for zakah. At the same time, Imam Syafi'i mentions only grapes and dates as agricultural products liable for zakah.

<sup>10</sup> Qardhawi (1993, 353-354), in one hand, agrees with Imam Abu Yusuf that other goods immeasurable in *wasq* should be equated with the actual price of other measurable goods. However, in other hand, Qardhawi refuses if the price used is the cheapest one among measurable goods.

<sup>11</sup> The Prophet said, "On a land irrigated by rain water or by natural water channels or if the land is wet due to a near by water channel *ushr* (i.e. one-tenth) is compulsory (as *zakah*); and on the land irrigated by the well, half of an *ushr* (i.e. one-twentieth) is compulsory (as *zakah* on the yield of the land)." (Bukhary).

<sup>12</sup> Different from Imam Hanbali's wide conclusion, Imam Hanafi's conclusion is limited to only mine goods processed with the fire. At the same time, Imam Syafi'i's conclusion is more limited to only gold and silver.

<sup>13</sup> It is precise that Imam Abu Hanifah, Abu Ubaid, and Zaid bin Ali, mention the 20% rate, whereas Imam Ahmad, Syafi'i, and Ishaq mention only 2½%. Imam Malik tends to choose moderate position and divide mining goods into two categories. First, mining goods obtained with very hard efforts, their rate are 2½%; Second, mining goods obtained without hard effort, their rate are 20%. See, Qardhawi (1993, 417-424).

<sup>14</sup> This statement is based on the opinions of Imam Malik, Imam Syafi'i, and Ahmad, as well as Ishaq. At the time, Imam Abu Hanifah does not requisite either time limit nor *nisab*. See, Qardhawi (1993, 424-427).

<sup>15</sup> As concluded by Imam Syafi'i, Malik, and Abu Hanifah, that gold and silver used for woman's jewelry is exempted from *zakah*.

<sup>16</sup> Different from the silver's *nisab* that is agreed by all Moslem scholars based on the *hadist*, "There is no zakah on less than five *awsuq*" (Muslim and Ahmad), this gold's *nisab* is agreed by only portions of Moslem scholars. The other scholars mention 40 *dinars*. On this matter, see Qardhawi (1993, 249-253).

595 grams silver and 85 grams gold).<sup>17</sup> Money and other financial deposits are also liable to *zakah* when reaching their *nisab*, which is more or less equal to silver's or gold's *nisab*. All of them with constant *zakah* rate equals to 2½%.

Fifth, commercial and industrial commodities. These include commodities in various forms and types, such as merchandises, machines, equipments of industry, and supplies. Commercial and industrial commodities are owned as a mean to invest and make profits.<sup>18</sup> Commercial and industrial commodities are therefore liable to *zakah* with the amount of *zakah* equals to 2½%.<sup>19</sup>

Collected *zakah* is further distributed to the eight channels (*al-ashnaf al-tsamaniyah*), i.e. the poor (people do not have property, do not have ability to work, and nobody is accounting them), the needy (people have property, have ability to work, but the income is falling short), and the people employed to administer *zakah*. Also the people whose hearts are made to embrace Islam, the people in bondage and do not ready to disentangle themselves, the people twined by debt, and the fighters in the cause of Allah, as well as the wayfarers (travelers with lawful purposes who has not enough money to return home).<sup>20</sup>

<sup>17</sup> These numbers, 595 grams for silver and 85 grams for gold is originated from Qardhawi (1993, 259), whereas the Joint Decision (SKB) of Indonesian Minister of Religious Affairs and Minister of Internal Affairs No. 29/47 Year 1991 mentions 672 grams for silver and 94 grams for gold.

<sup>18</sup> Machines and equipments of industry are liable for *zakah* because of their growing feature and not of their traded material.

<sup>19</sup> This position is based on the opinions of Imam Ibnu Akil from Mazhab Hanbali and Imam Ahmad, though the two hold different arguments. Several contemporary scholars mention the proportion of 10% and 5% as agricultural products. See, Qardhawi (1993, 441-455).

<sup>20</sup> At-Taubah 9:60.

## THE RELATIONSHIP BETWEEN ZAKAH AND TAXATION

Discussions concerning the relationship between *zakah* and taxation have been starting since the early days of Islam. At that moment, Moslems just succeed to conquer Iraq. Khalifah Umar, of his ministrants' suggestions, decided not to allot war booty, including the grounds in the conquered region. While many grounds grabbed with the strengths of war were specified as the property of Moslems, other lands conquered with agreements were retained as the property of local residents. Consequently, these local residents were obliged to pay *kharaj*, even when they further embracing Islam (Sabzwari, 2001).<sup>21</sup> It is this history is presumably as becoming the early application of tax (beside *zakah*) on Moslems.

The withdrawal of tax beside *zakah* hereinafter continues to take place with different reasons. Among other reasons enabled by Moslem scholars are: First, to realize social security, which is imperative for every Moslem. Second, to fulfill the plenty requirements of state defrayal beyond those destined for *al-ashnaf al-tsamaniyah*. Third, to prevent the greater loss possibly happening when the small loss (paying tax) is not to be done, such as health and security services. Fourth, to fulfill the obligation of *jihād* in the way of Allah, particularly with one's wealth. And fifth, related to the method of *ushul fiqh "alghunmu-bilghurmi"*, meanings sacrifice changed with benefit, tax levied by government must be changed with other benefits and facilities which are truly carried out with the tax (Qardhawi, 1993).

Along time's journey, relationship between *zakah* and taxation becomes inversing. Started with the decline of Moslems' life, European colonization, and the hege-

<sup>21</sup> Previously, *kharaj* is only imposed on the lands owned by non-Moslems. With this regulation, lands owned by Moslems are also imposed with *kharaj* besides *ushr*.

mony of Western civilization, Islamic laws are hereinafter left, and western human-made laws are being majored. The obligation of *zakah* is subordinated and substituted with the obligation of tax. As a result, the unique question emerges: Is it an obligation for Moslems to pay *zakah* when they having pay tax?<sup>22</sup>

Referring to the historical process above, we know that there is no reason to liken *zakah* with taxation. First, evaluated from its definition and purpose, *zakah* is a religious service of *maliah ijtima'iyah* obliged by Allah to every Moslem. The purpose of *zakah* is to sanctify Moslems' soul and wealth, implement their feels of thanks, and realize adherence to His command. At the same time, tax is an obligation to every citizen, with various targets, to realize people's civic awareness. Tax, thereby, do not have any direct relationships with religious practice.

Second, viewed from its *nisab* and rate, *zakah* is fixed, as determined by Allah. Nobody has the entitlement to change it, adding or lessening it, for the reason of corresponding with the development of economy. On the contrary, the obliged amount and constrain of taxation is changeable at any times according to the requirements of economy.

Third, viewed from the object, *zakah* is only imposed on every soul (*zakah al-fitr*) and certain properties meeting the standardized measures (*zakah al-maal*). Among others are cattle and other animals, crops and fruits, found goods, gold and silver, and commercial and industrial commodities.

<sup>22</sup> Imam Nawawi from *mazhab* Syafi'i, Imam Ahmad, and Ibnu Taimiyah contend that paying tax for the intention of *zakah* is permissible, and hence, Moslems needs only to pay the tax. On the contrary, Ibnu Hajar al-Haisyami from *mazhab* Syafi'i, Ibnu Abidin from *mazhab* Hanafi, and Syekh Ulaith from *mazhab* Maliki contend that *zakah* and taxation are different and the payment of tax does not eliminate the obligation to pay *zakah*. See, Qardhawi (1993).

Some additions are possible, but they must be resulted from Moslem scholars' *ijtihad* with a tight guidance from the Quran and Sunnah. On the contrary, tax can be imposed on any objects as long as the process is legally validated with approval from the house of representative.

Fourth, viewed from the targets, *zakah* can only be distributed for the eight channels, i.e. the poor, the needy, the people employed to administer *zakah*, and the people whose hearts are made to embrace Islam, the people in bondage, the people twined by debt, the fighters in the cause of Allah, as well as the wayfarers. On the contrary, tax can be utilized for anything appropriate with government expenditure planning, including both routine and development expenses.

Debates concerning the obligation of *zakah* after tax payment should be returned to the fundamental root of the problem. That is, the subordination of *zakah* under taxation so that Moslems wishing to pay *zakah* have to bear double burden. It is this homework need to be paid attention by Moslems.

## ZAKAH AND TAXATION IN INDONESIAN CONSTITUTIONS

It has been mentioned that Indonesia is a secular state dissociating positive laws with the religious ones. Therefore, revenue system in government fiscal policy is based on taxation rather than *zakah*. Consequently, a Moslem wishing to pay *zakah* will be double burdened. First, paying tax according to positive laws; Second, paying *zakah* according to the Islamic teachings.

In such contexts, the prevailing of Act No. 38/1999 concerning *Zakah* Management and Act No. 17/2000 concerning Third Change of Act No. 7/1983 on Income Tax can be viewed as an advanced step toward the harmonization of *zakah* and taxation.

First, Act No. 38/1999 has confessed that *zakah* is an obligation, which must be executed by every Indonesian capable Moslem.<sup>23</sup> This law mentions no exact penalization for those ignoring the obligation of *zakah*, but least of all, government has explicitly hold responsible to give protections, constructions, and services to *muzaki*, *mus-tahiq*, and *amil zakah*.<sup>24</sup>

Second, government has entangled themselves farther in *zakah* management by founding *Badan Amil Zakah* at various governmental levels, from district to national.<sup>25</sup> Likewise, government confirms and observes *Lembaga Amil Zakah*, which is self-supporting by the society.<sup>26</sup>

Third, as mentioned in Act No. 38/1999, *zakah* bestowed to *Badan Amil Zakah* or *Lembaga Amil Zakah* will be considered as deductible for taxpayers' taxable profits or incomes.<sup>27</sup> In Act No. 17/2000 is also contended that *zakah* officially bestowed by Moslem personal taxpayers and or Moslem-owned domestic taxpayer bodies, can be considered as deductible for their taxable incomes.<sup>28</sup> In other words, as has been mentioned in the Decision of the Director General of Taxation No. KEP-542/PJ/2001, that *zakah* of income can be considered as deductible for one's net incomes.<sup>29</sup>

For example, a Moslem entrepreneur has a gross income equals to IDR 75 millions.<sup>30</sup> After reduced by IDR 50 millions investment costs and IDR 15 millions operational costs, the net income he obtains is

IDR 5 millions. Pursuant to progressive tariff,<sup>31</sup> such an entrepreneur is obliged to pay of 10% income tax times IDR 5 millions net income, i.e. equals to IDR 500 thousands.

But, of his own awareness as a Moslem, the entrepreneur chooses to pay of 2½% *zakah* from gross income, that is 2½% *zakah* rate times IDR 70 millions, equals to IDR 1.750.000. This latest amount is hereinafter considered as deductible for the IDR 5 millions net income, so that the remaining net income is IDR 3.250.000. Pursuant to the same progressive tariff, the amount of income tax obliged to the entrepreneur is 10% times the remaining IDR 3.250.000 net income, i.e. equals to IDR 325.000.

It is however important to note that Act No. 17/2000 and Act No. 38/1999 are not consistent with each other. While Act No. 17/2000 states that *zakah* which can be considered as deductible for taxable income is only *zakah* of income, Act No. 38/1999 mentions that *zakah* (without the additional word "income") can be considered as deductible for one's taxable income.<sup>32</sup> In this Act No. 38/1999, *zakah* (without additional word "income") is defined as properties must be bestowed by Moslems according to Islamic teaching, including among others gold and silver, commercial and industrial commodities, crops and fruits, and found goods, as well as cattle and other animals.<sup>33</sup>

Such an inconsistency is likely caused by two factors. First, misunderstanding among the members of Indonesian house of representative (DPR RI) concerning *zakah*. Second, different positions among the members of Indonesian house of representative (DPR RI) concerning the extent that *zakah* "can" be adopted in Indonesian political and economic policy.

<sup>23</sup> Act No. 38/1999 article 2.

<sup>24</sup> Act No. 38/1999 article 3.

<sup>25</sup> Act No. 38/1999 article 6.

<sup>26</sup> Act No. 38/1999 article 7.

<sup>27</sup> Act No. 38/1999 article 14 point (3).

<sup>28</sup> Act No. 38/1999 article 9 point (1) letter g

<sup>29</sup> The Decision of the Director General of Taxation No. KEP-542/PJ/2001 letter k number 6 "Formulir SPT Tahunan PPh Wajib Pajak Orang Pribadi formulir 1770"

<sup>30</sup> *Bisnis Indonesia*, 29th October 2001, pp. 13.

<sup>31</sup> Act No. 17/2000 article 17 point (1) letter a for domestic personal taxpayers.

<sup>32</sup> Act No. 38/1999 article 14 point 3

<sup>33</sup> Act No. 38/1999 article 1 point 2, and article 11 point (1) and (2)

**THE IMPACTS OF ZAKAH ON  
INDONESIAN MACROECONOMY**

The application of *zakah* of income (or more precisely *zakah* of commercial and industrial commodities) as deductible for taxable income will directly affect government's revenues from taxation. The more Moslems paying *zakah*, the more is deductible. Taxable income decreases and, consequently, government's revenue from taxation declines.<sup>34</sup>

At the same time, government is struggling to increase its revenues from taxation. Targeted tax ratio in 2002 government budget (APBN) is 13,03%, higher than that being predicted before (12,8%). Pursuant to IDR 1417,306 billions total government budget in 2002, the targeted revenue from taxation is IDR 184,675 billions.<sup>35</sup>

It is this factor is likely responsible for government's acrophobia and hesitation in *zakah* management. Government is apprehensive about the revenues being targeted from taxation.

Below are detail analyses on the effect of *zakah* as deductible for taxable income, particularly on the economy. Whether it causes loss, or conversely, results in benefit?

**The Impacts of Zakah on Aggregate Consumption**

To start our analysis, assume that: First, *zakah* is imposed on every commercial and industrial commodities owned by Moslems, both in individual and industrial terms. Second, the number of Moslems paying commercial and industrial commodity *zakah* is significant, covering a certain proportion of Indonesian national income. Third, the movements for Islamic missionary and *za-*

*kah* awareness propaganda are prospering; so that many Moslems have willingness to pay *zakah*. Fourth, the proportion of collected *zakah* is fixed and amounting to a certain proportion of national income. Fifth, *zakah* bestowed by *muzaki* is hereinafter distributed to *mustahiq*. Sixth, *mustahiq* receiving *zakah* have a relatively higher marginal propensity to consume than *muzaki*. Seventh, while *zakah* bestowed by *muzaki* is considered as deductible for taxable income, *zakah* received by *mustahiq* is exempted from such taxation.<sup>36</sup>

If *C* is the level of aggregate consumption, *c* is the autonomous consumption,  $\alpha$  is the level of marginal propensity to consume (MPC), and *Y* is national income, the aggregate consumption function is given by:

$$C = c + qY_d \dots\dots\dots(1)$$

The economy consists of two different characteristics, i.e. *muzaki* and *mustahiq*. Consequently, equation (1) needs to be rewritten as,

$$C = c + aY_a + bY_b \dots\dots\dots(2)$$

where *a* and *b* represent *muzaki*'s and *mustahiq*'s marginal propensity to consume (MPC) respectively, and *Y<sub>a</sub>* and *Y<sub>b</sub>* represent disposable income in each economic character.

*Muzaki* hold a certain proportion of national income, *mY*, and the remaining (1 - *m*)*Y* is belonging to *mustahiq*. If government's transfer, *Tr*, is assumed to be zero, and *T<sub>x</sub>* = *tY* is representing tax, the economic functions without *zakah* will be as following:

$$C = c + aY_a + bY_b$$

where,

$$Y_a = mY - tmY \dots\dots\dots(4)$$

and

$$Y_b = (1 - m)Y - t(1 - m)Y \dots\dots\dots(5)$$

so that

<sup>34</sup> Zakah can decline income tax in two ways. First, to deduct taxable income; Second, for several cases, also deduct progressive tariff. See, Act No. 17/2000 article 17 point (1) letter a and b.

<sup>35</sup> www.tempo.co.id/news/2001/12/13/1,1,39,id.html-16k

<sup>36</sup> Act No. 17/2000 article 4 point (3) letter a.

$$C = c + amY - atmY + bY - bmY - btY + btmY \quad (6)$$

Average propensity to consume (APC) equals to consumption level divided by national income, and marginal propensity to consume (MPC) equals to the first derivation of consumption level. Without commercial and industrial commodity *zakah* as deductible for income tax, the value of APC and MPC are respectively provided by

$$APC_{Z=0} = \frac{C}{Y} = \frac{c}{Y} + am - atm + b - bm - bt + btm \quad (7)$$

$$MPC_{Z=0} = \frac{dC}{dY} = am - atm + b - bm - bt + btm \quad (8)$$

*Zakah* of commercial and industrial commodities,  $xY$ , will in one hand subtract *muzaki's* taxable income, and in the other hand, exempt from *mustahiq's* taxable income. Here, equations (2), (4), (5), and (6) can be rearranged as:

$$C = c + aY_a + bY_b$$

where,

$$Y_a = mY - xY - tY_z \quad (9)$$

$$Y_z = mY - xY \quad (10)$$

$$Y_b = (1 - m)Y + xY - t(1 - m)Y \quad (11)$$

so that

$$C = c + amY - axY - atmY + atxY + bY - bmY + bxY - btY + btmY \quad (12)$$

Average propensity to consume (APC) and marginal propensity to consume (MPC) are respective functions of national income. With commercial and industrial commodity *zakah*, the value of APC and MPC are represented by

$$APC_{Z>0} = \frac{C}{Y} = \frac{c}{Y} + am - ax - atm + atx + b - bm + bx - bt + btm \quad (13)$$

$$MPC_{Z>0} = \frac{dC}{dY} = am - ax - atm + atx + b - bm + bx - bt + btm \quad (14)$$

Subtracting  $APC_{Z=0}$  and  $MPC_{Z=0}$  respectively from  $APC_{Z>0}$  and  $MPC_{Z>0}$ , we find that:

$$\Delta APC = x(b - a + at) \quad (15)$$

and,

$$\Delta MPC = x(b - a + at) \quad (16)$$

Since the value of  $a$  and  $b$  follow  $0 < a < b < 1$ , and the amount of  $t$  follows  $0 < t < 1$ , we can then conclude that the value of  $\Delta APC$  and  $\Delta MPC$  are positive. The relationship between  $APC_{Z>0}$ ,  $APC_{Z=0}$ ,  $MPC_{Z>0}$ , and  $MPC_{Z=0}$  can therefore be stated as:

$$APC_{Z>0} > APC_{Z=0} \quad (17)$$

and,

$$MPC_{Z>0} > MPC_{Z=0} \quad (18)$$

### The Impacts of Zakah on Savings

Savings is a direct difference between national income and aggregate consumption. Mathematically, the relationship between savings, national income, and consumption is given by:

$$S = Y - C \quad (19)$$

Substituting equation (6) into equation (19) we obtain:

$$S = Y - c - amY + atmY - bY + bmY + btY - btmY \quad (20)$$

which is a function of savings without commercial and industrial commodity *zakah*.

In line with APC and MPC, average propensity to save (APS) equals to savings level divided by national income, and marginal propensity to save (MPS) equals to the first derivation of savings. Here, we obtain the equation of APS and MPS without *zakah*

$$APS_{Z=0} = \frac{S}{Y} = 1 - \frac{c}{Y} - am + atm - b + bm + bt - btm \quad (21)$$

and,

$$MPS_{Z=0} = \frac{dS}{dY} = 1 - am + atm - b + bm + bt - btm \quad (22)$$

Bestowed commercial and industrial commodity *zakah* can be counted as deductible for taxable income. Substituting equation (12) into equation (19), the function of savings is provided by:

$$S = Y - c - am + ax + atm - atx - b + bm - bx + bt - btm \quad (23)$$

Equation (23) divided by national income will result in the function of average propensity to save. Likewise, if equation (23) is derived, it will result in the function of marginal propensity to save.

$$APSS_{Z>0} = \frac{S}{Y} = 1 - \frac{c}{Y} - am + ax + atm - atx - b + bm - bx + bt - btm \quad (24)$$

$$MPS_{Z>0} = \frac{dS}{dY} = 1 - am + ax + atm - atx - b + bm - bx + bt - btm \quad (25)$$

Subtracting  $APSS_{Z=0}$  and  $MPS_{Z=0}$  respective from  $APSS_{Z>0}$  and  $MPS_{Z>0}$ , we obtain  $\Delta APS = x[a(1-t) - b]$  ..... (26) and

$$\Delta MPS = x[a(1-t) - b] \quad (27)$$

Since the value of  $a$  and  $b$  follow  $0 < a < b < 1$  and the value of  $t$  follows  $0 < t < 1$ , we can conclude that  $\Delta APS$  and  $\Delta MPS$  are negative. The relationship between  $APSS_{Z>0}$ ,  $APSS_{Z=0}$ ,  $MPS_{Z>0}$ , and  $MPS_{Z=0}$  can be written as:

$$APC_{Z>0} < APC_{Z=0} \quad (28)$$

and

$$MPC_{Z>0} < MPC_{Z=0} \quad (29)$$

### The Impacts of Zakah on Investment

Investment is expenditures used for the purchasing of capital goods and production equipments, which are intended to add capability in producing goods and services in economy. In general, investment is classified into induced investment and autonomous investment (Sukirno, 1999).

Investment decision is influenced by among others expected rate of return and the rate of interest. Investor decides to invest if the present value of his future income is higher than the present value of his invested capital. Assuming that  $PV$  represents the present value of income earned in year 1 to year  $n$ ;  $Y_{\alpha 1}$ ,  $Y_{\alpha 2}$ ,  $Y_{\alpha 3}$ , ...  $Y_{\alpha n}$  represent com-

panies' net income; and  $r$  represents the prevailing interest rate; then the present value of future incomes is:

$$PV = \frac{Y_{\alpha 1}}{(1+r)} + \frac{Y_{\alpha 2}}{(1+r)^2} + \dots + \frac{Y_{\alpha n}}{(1+r)^n} = \sum_{i=1}^n \frac{Y_{\alpha i}}{(1+r)^i} \quad (30)$$

Net income earned by the companies is total income subtracted by income tax. Hence, equation (30) can be rewritten as:

$$PV = \frac{Y_{\alpha 1} - tY_{\alpha 1}}{(1+r)} + \frac{Y_{\alpha 2} - tY_{\alpha 2}}{(1+r)^2} + \dots + \frac{Y_{\alpha n} - tY_{\alpha n}}{(1+r)^n} = \sum_{i=1}^n \frac{Y_{\alpha i} - tY_{\alpha i}}{(1+r)^i} \quad (31)$$

*Zakah* of commercial and industrial commodity prevails as deductible for taxable income. Considering *zakah* into equation (31), the present value of future income is given by:

$$PV = \frac{Y_{\alpha 1} - xY_{\alpha 1} - t(Y_{\alpha 1} - xY_{\alpha 1})}{(1+r)} + \frac{Y_{\alpha 2} - xY_{\alpha 2} - t(Y_{\alpha 2} - xY_{\alpha 2})}{(1+r)^2} + \dots + \frac{Y_{\alpha n} - xY_{\alpha n} - t(Y_{\alpha n} - xY_{\alpha n})}{(1+r)^n} = \sum_{i=1}^n \frac{Y_{\alpha i} - xY_{\alpha i} - t(Y_{\alpha i} - xY_{\alpha i})}{(1+r)^i} \quad (32)$$

Assuming further that the present value of invested capital is  $\sum_{i=1}^n \frac{K_i}{(1+r)^i}$ , and commercial and industrial commodity *zakah* must be paid on capital is  $xK_i$ , we know that investment will profit when

$$\sum_{i=1}^n \frac{K_i}{(1+r)^i} < \sum_{i=1}^n \frac{Y_{\alpha i} - tY_{\alpha i}}{(1+r)^i} \quad (33)$$

or

$$\sum_{i=1}^n \frac{K_i - xK_i}{(1+r)^i} < \sum_{i=1}^n \frac{Y_{\alpha i} - xY_{\alpha i} - t(Y_{\alpha i} - xY_{\alpha i})}{(1+r)^i} \quad (34)$$

### The Impacts of Zakah on Equilibrium National Income

Referring to aggregate demand supply approach,<sup>37</sup> the function of equilibrium national income is provided by the equation

<sup>37</sup> The other one is injection-leakage approach. Assuming that  $(X - M)$  is zero, we obtain the function of equilibrium national income  $I + G = S + Y$ .

$$Y = C + I + G + (X - M) \dots\dots\dots (35)$$

$I$  represents investment,  $G$  represents government's expenditure, and  $(X - M)$  represents net international trade.

Assuming that investment,  $I = \bar{I}$ , is constant, government's expenditure,  $G = \bar{G}$ , is also constant, and the net international trade  $(X - M)$  is zero, then equation (35) can be rewritten as:

$$Y = C + \bar{I} + \bar{G} \dots\dots\dots (36)$$

Substituting  $C$  from equation (6) and (12) into equation (36), we obtain the functions of equilibrium national income with and without commercial and industrial commodity *zakah* are

$$Y_{Z=0} = \frac{c + \bar{I} + \bar{G}}{1 - am + atm - b + bm + bt - btm} \dots\dots (37)$$

and

$$Y_{Z>0} = \frac{c + \bar{I} + \bar{G}}{1 - am + ax + atm - atx - b + bm - bx + bt - btm} \dots\dots (38)$$

Denominator in equation (37) is considered as deductible for denominator in equation (38), we obtain:

$$\Delta = x[-a(1+t) - b] \dots\dots\dots (39)$$

Since the value of  $a$  and  $b$  follow  $0 < a < b < 1$ , and the value of  $t$  follows  $0 < t < 1$ , we can conclude that the result in equation (39) is negative. Denominator in equation (37) is more than the other one in equation (38). Clearly, it can be said that:

$$Y_{Z>0} > Y_{Z=0} \dots\dots\dots (40)$$

Without *zakah*, aggregate consumption function intersects the 45-degree line at point a, resulting  $0Y_{Z=0}$  national income. Likewise, the same finding is resulted from injection-leakage approach, within which the  $(S+T)_{Z=0}$  curve intersects  $(I+G)$  curve at point c.

With commercial and industrial commodity *zakah*, aggregate consumption function is higher,  $C_{Z>0}$  curve intersects the

45-degree line at point  $b$ , and national income changes to be  $0Y_{Z>0}$ . This finding is robust, and similar with that resulted from injection-leakage approach, within which  $(S+T)_{Z>0}$  curve intersects  $(I+G)$  curve at point  $d$ .

Question that is arising here is, whether the increase of consumption (or conversely the decrease of savings) will not cause loss for the economy? Referring to the concept of "fallacy of composition", we see that the answer is not! Saving behavior is certainly good for the individuals. However, if every individual does the same savings, the effect is exactly negative for the economy (Reksoprayitno, 1985).

Likewise, referring to the concept of "golden rule level of capital", we know that there is only one precise level of savings, i.e. the level results in maximum satisfaction of aggregate consumption. Savings level that is too high –just like too low– will negatively affect the economy, i.e. decreasing the satisfaction of aggregate consumption (Mankiw, 1999).

## CONCLUSION

*Zakah* has a very important meaning in Islam and must be bestowed by every Moslem. Government holds responsibility to motivate and facilitate Moslems so that they can implement all their religious duties including *zakah*.

Using several models, we can prove that the effect of commercial and industrial commodity *zakah* as deductible for taxable income is positive on aggregate consumption level. The average propensity to consume and marginal propensity to consume is higher with *zakah* relative to that without *zakah*.

On the contrary, the effect of commercial and industrial commodity *zakah* is negative on savings. The average propensity to save and marginal propensity to save is

lower with *zakah* relative to that without *zakah*.

The effect of commercial and industrial commodity *zakah* on investment cannot be determined directly as investment is much more influenced by two other variables, i.e. expected rate of return and rate of interest. The effect of commercial and industrial commodity *zakah* is, in this case, limited to only changes the standard composition of investor's decision making.

Finally, the effect of commercial and industrial commodity *zakah* is positive on equilibrium national income. Although commercial and industrial commodity *zakah* lessens government's revenues from taxation, but the condition of economy as a whole will be better. The equilibrium national income is higher with *zakah* relative to that without *zakah*.

Thereby, government needs not to be hesitating to execute Act No. 38/1999 and Act No. 17/2000. On the contrary, government has to be more active in making *Zakah* Consciousness Movement successful, among others by completing the regulations and constructing and observing *Badan Amil Zakah* and *Lembaga Amil Zakah*. Last but not least, government has also to motivate Moslems to obey the obligation of *zakah*.

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