

DOES REGULATION INCREASE ZAKAT PAYMENT?

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ABSTRACT

The objective of this paper is to explore how zakat as tax deduction affects zakat payment. This topic is important for understanding corporate compliance to sharia and rules of the country. Using database of Thompson Reuters over 2007-2018, sample of this research comprises all islamic organization which discloses zakat payment. Final sample for this study is 709 observations. Different with previous study, this study is cross country analysis so that result of the study is more generable than before and look carefully at zakat as tax deduction. The finding indicates that regulation affects the zakat payment. Unfortunately, the different between regulation which treats zakat as a deduction for taxable income and zakat as tax rebate is not significant. In addition, based on descriptive statistic finding, zakat payment in zakat as deduction from tax liability regulation is higher than zakat as deduction from taxabale income regulation. Results of this study provide empirical evidence to support government for confirming zakat law. This is the first study in cross country so that this finding lays some foundation for zakat law.

Keywords: Zakat, Regulation, Reputation.

INTRODUCTION

Recently, Islamic companies continue to grow rapidly. Based on State of the Global Islamic Economy Report 2016/2017, 86% of participants are optimistic related to the future prospects of the Islamic industry (Kimata, Shinomiya, & Mikawa, 1983). This entities should consistently ensure that their practice complies to the sharia principles. One of this principle is zakat compliance. It is reflection of worship to Allah by being caring and compassionate.

Number of verses in Quran and hadith describe an advantage of being caring and compasionate to the community. The Prophet Muhammad (SAW) said,

“Protect yourself from hell-fire even by giving a piece of date as charity.” (Al-Bukhari and Muslim). In Qur’an, Allah (SWT) also has stated that,

“Who is it that would loan Allah a goodly loan so He may multiply it for him many times over? And it is Allah who withholds and grants abundance, and to Him you will be returned.” (The Holy Qur’an, 2:245)

Corporate zakat defined as the act of institution donation to community and social when its asset achieves the *haul* and *nishab*. This donation will supports community needs such as education, healthcare, and others (Godfrey, 2005; Wang, Choi, & Li, 2008). Related to this importance, Vinnicombe (2010) showed that zakat is the most important thing for Islamic companies because they should consistently complies to the sharia principles. McGee

(1998) indicated that payment of zakat is important because it supports the poor needs. Also in the Islamic compliance index, zakat is one of measures in this calculation.

Previous research ignores zakat regulations for zakat deduction in the cross country level. Whereas the study of zakat is closely related to regulation zakat as a tax deduction in a country. This is because regulations in various countries have governed differently regarding zakat as a tax deduction (Obaidullah, 2016; Ridwan, 2014). Despite previous studies such as Javaid & Al-Malkawi (2018); Menne, Winata, & Hossain (2016); Reskino, (2016); Samad, Said, Kamarulzaman, & Mahshar (2015) have explained that zakat is associated with financial performance but it has not included regulation that zakat as a tax deduction. To the authors' knowledge, there is no empirical research which investigated the impact of regulation towards zakat payment.

The remainder of this paper is well organized as follows. Section 2 discusses literature review and development of hypotheses. Section 3 describes research design, variable measurement, and empirical models. Section 4 discusses main results of study. Section 5 offers conclusion and avenue for next study.

LITERATURE REVIEW

As an Islamic entities, they should comply Shariah principles such as corporate zakat payment. The issue of corporate zakat was first introduced at the first zakat conference held in Kuwait in 1984. The results of the conference explained the compulsory corporate zakat as quoted by Nadzri (2009) as follows,

*“Company is considered as a separate legal entity, the company is **liable for zakah** either for itself or on behalf of its shareholders, subjected to the following conditions(2009)”*.

For that, Islamic entities have high pressure to ensure that their business practices are consistent with islamic principles and regulation. Being caring and compassionate corporate by zakat payment is obligation after syahadat, prayer, fasting in Ramadan and Hajj. Some verses in Quran stated as a follows,

“O you who believe! Verily, there are many of the rabbis and the monks who devour the wealth of mankind in falsehood, and hinder (them) from the way of Allah. And those who hoard up gold and silver, and spend it not in the Way of Allah-announce unto them a painful torment” (Quran 9:34).

The existence of Islamic companies raises new risks, called sharia non-compliance risk. Islamic companies must adhere to the principles of Shari'a and religious values, including zakat, operate in the halal sector, and avoid usury (Alam et al., 2017). Sharia non-compliance risk is defined as the risk of loss arising from the failure of a Sharia entity to comply with Sharia values and principles which determined by the Shari'a board or related body in the jurisdiction.

In the context of regulations requiring zakat (mandatory), the issue of non-compliance becomes crucial because it will creates perceptions among stakeholders. Company compliance to sharia principles affects and enhances the company's reputation (Nomran, Haron, & Hassan, 2018). For this reason, when the company's reputation increases, the company's stakeholders tend to provide high concern. The concern of stakeholders creates company competitiveness such as shareholder loyalty and protection of the company (Brown, Helland, & Smith, 2006). The company's competitiveness creates operational efficiency, lowers costs, and increases profits for shareholders.

Each country has different zakat regulations for zakat deduction. Obaidullah (2016) explains that some countries provide regulations whether zakat is a deduction from taxable income, or whether zakat is a deduction of tax debt (tax rebates), or zakat is not a deduction from tax. The comparison between regulation zakat as tax liability deduction and zakat as taxable deduction as follows,

Description	<i>Zakat as tax liability deduction</i>	<i>Zakat as taxable income deduction</i>
<i>Income- (I)</i>	100	100
<i>Zakat – (Z)</i>		(15)
<i>Taxable Income</i>	100	85
Tax (Tariff 25%) – (t)	25	21,25
<i>Zakat – (Z)</i>	(15)	
Tax	10	21,25
Zakat	15	15
Total Tax & Zakat	25	36,25
Net Income After Zakat and Tax	75	63,75

Based on the argumentation of Nurhayati & Siswantoro (2015), the incentive to pay zakat in a country with regulation zakat as a tax liability deduction is higher than a country with regulation zakat as a deduction for taxable income. This phenomenon caused by total tax and zakat that must be paid in the "zakat as tax deduction" regulation is the smallest nominal amount.

This paper is the first investigation which investigated the impact zakat regulation on zakat payment. For that, this paper contributes shedlight on the regulation and zakat relationship. Due to these argument, this paper suggest hypothesis that, In zakat as tax liability deduction regulation, payment of zakat is higher than in zakat as taxable income deduction regulation.

DATA AND RESEARCH METHODOLOGY

This section describe data and methodology to test hypothesis of paper. In addition, this section also discusses proxies for zakat, dummy regulation, and control variables. The samples for this study is Kuwait, Saudi Arabia and Malaysia because it has reflected differences in zakat regulations, zakat as a deduction from tax liability and zakat as a deduction from taxable income. Kuwait and Saudi Arabia are countries that have regulations that zakat as a deduction from tax liability. Malaysia is one of the countries that have regulations that zakat as a deduction for taxable income for non-offshore companies.

The Data

The sample data was obtained from Thomson Reuters database that covers Kuwait, Saudi Arabia, and Malaysia for the period from 2007 to 2018 (12 years). This study uses a sample of institution who publish zakat payment. The final number of observations is 709 consist of 628 observations in regulation zakat as deduction from tax liability and 81 observations in regulation zakat as deduction from taxable income. Accounting and financial data of company also collected from Thomson Reuters the for measuring control variables.

Variable Measurement

Proxy for zakat is measured using natural logarithm of zakat payment. This measure shows the intensity level of corporate charity. Formula for this proxy as follows,

$$\text{Zakat} = \text{Ln Zakat}$$

Thompson Reuters defines zakat as follows, *Represents an Islamic wealth tax which is treated as any other tax on income, irrespective of where it is reported in the Income Statement.*

Measurement of regulation for zakat deduction is dummy. Based on research results of Obaidullah (2016), Kuwait and Saudi Arabia perceives zakat as a deduction from tax liability. In Malaysia, zakat is a deduction from taxable income.

Control Variables

The control variables in this study are industrial specialties (INDUSTRI) and previous net income (NI_{t-1}). These control variables have been used in for controlling other factors seems affect zakat payment.

Empirical Design

To test research hypotheses, this study use regression mode that specified as follows.

$$\text{Ln Zakat} = \alpha_1 + \alpha_2 \text{DRegulation}_{it} + \alpha_3 \text{controls}_{it} + \varepsilon_{it}$$

This study using panel data for 12 years since 2007. In this equation, α_2 should be negative because dummy 1 for zakat as deduction from taxabale income. Also this coefficient for addressing the hypothesis. α should be significant for suggesting that zakat is affected significantly by regulation. In addition, sign α coefficient also is important for considering the arguments background.

EMPIRICAL RESULT

Table 1 presents summary of descriptive statistics for sample characteristics of Islamic firms. Looking at the twelve-year average, the mean for zakat payment is also \$ US 18.600.000 in regulation which zakat as deduction from tax liability and \$ US 1.325.368 for regulation which zakat as deduction from taxable income.

GDP is an indicator of prosperity and welfare of a country. Based on GDP data obtained at the World bank, three countries that became the study sample (Kuwait, Saudi Arabia, and Malaysia) showed that GDP varied. This is to provide an argument that the research sample is varied so that it has reflected the population.

Total asset is also an indicator of corporate size. Based on total aset data obtained at the thompson reuters, research sample which consist of 709 observation is varied and is reflected the population (Table 2).

Table 2 DESCRIPTIVE STATISTIC				
DEDUCTION FROM TAX LIABILITY				
	Zakat	Total Aset (US\$ Juta)	GDP	NI_{t-1}
Min	989.77	26.40	16113.1	-0.251
Mean	18600000	4690	25907.14	0.07
Max	800000000	124000	55495.20	0.514
SD	83700000	14400	9277.40	0.08
N	628	628	628	628

DEDUCTION FROM TAXABLE INCOME				
	Zakat	Total Aset (US\$ Juta)	GDP	NI _{t-1}
Min	7453.42	58.40	7243.46	-0.29
Mean	1325368	4890	10335.65	0.03
Max	18000000	37200	11319.10	0.216
SD	2178558	5820	869.02	0.05
N	81	81	81	81

Based on descriptive statistic, mean of zakat payment in regulation which zakat as deduction from tax liability is higher than mean in regulation which zakat as deduction from taxable income. It is consistent to literatur review and argument which indicated that zakat payment in regulation zakat as deduction from tax liability is better than zakat payment in regulation zakat as deduction from taxable income because zakat that must be paid in the "zakat as tax deduction" regulation is the smallest nominal amount. It is consistent to argument of Siswantoro & Nurhayati (2015) which states that incentive to pay zakat in a country with regulation zakat as a tax liability deduction is higher than a country with regulation zakat as a deduction for taxable income.

Calculation of zakat payment based on income or wealth of company. Table 3 presents correlation between zakat and net income or asset. Note that the analysis of correlation shows the positive relationship, it is indicated that higher asset or net income has higher zakat payment.

Table 3 CORRELATION TABLE			
	Lnzakat	Logta	Net Income
Lnzakat	1		
Logta	0.621***	1	
Net Income	0.441***	0.490***	1
* p<0.05, ** p<0.01, *** p<0.001			

For testing research hypothesis, result on regression tests in Table 4 addresses the question whether regulation affects on zakat payment. Focus on research hypothesis, result strongly support hypothesis that regulation is significantly affects zakat payment. It indicates that zakat payment in regulation as deduction from tax liability is better than zakat payment in regulation which zakat as deduction from taxable income. This study supports previous argument which indicates that zakat payment incentive in a country with regulation zakat as a tax liability deduction is higher than a country with regulation zakat as a deduction for taxable income (Siswantoro & Nurhayati, 2015).

Table 4 REGRESSION RESULT FOR ZAKAT	
VARIABLES	LNZAKAT
Deduct form Taxable Income	-1.653***
Non Financials	1.517***
NI _{t-1}	2.316***
Constant	13.16***
Observations	709
Number of nama perusahaan	170
*** p<0.01, ** p<0.05, * p<0.1	

This study has implication that regulation which zakat as deduction from taxable income is less impact than zakat as deduction from tax liability on zakat payment. For that,

regulation is mechanism for increasing zakat payment This finding consistent with previous argument who argued that different regulation provides different impact on zakat payment.

Bushman & Piotroski (2006) have explained that the institutional structure of a country creates incentives that influence the behavior of stakeholders such as company management, investors, government, and other stakeholders. These institutional factors comprise a country's regulations, economic and political conditions, the capital market system, and taxation law. To that end, the tax deduction regulation of zakat affects corporate zakat.

CONCLUSION

This study examines the impact of regulation on zakat payment. This results shed light on the relationship between regulation and zakat payment. This paper result shows that regulation have impact of zakat payment. This finding consistent with argument of Bushman & Piotroski (2006) which indicated that the institutional structure such as regulation provides influence to the behavior of stakeholders. It also support hypothesis which indicates that regulation affect zakat payment. Beside that, it also indicates that zakat as deduction form tax liability is better than zakat as deduction form tax liability for increasing tax payment.

This finding provides several unique contributions to the research of the association between regulation and zakat payment. By focusing on cross-country analysis, it enhances comparative study between regulation. Thus, this finding as based for next study. This result allows make better understanding on how regulation affects zakat payment. The limitation for this study is regarding sample from Malaysia entities. This study does not ensure that sample of Malaysian entities in this paper are only for non-offshore companies. As Obaidullah (2016) stated that the regulation on zakat for business entities in Malaysia applied tax rebate for offshore companies and tax deduction for the rest. Therefore, next study should carefully ensures that sample of Malaysian entities are only for non-offshore companies. The next limitation is regarding the observations issue. This study only provides 628 observations in regulation zakat as deduction from tax liability and 81 observations in regulation zakat as deduction from taxable income. The inequality of observations triggers question are they comparable. For that, future research should consider this issue.

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