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Wealth Tax: Opportunities for the Integration Between Zakat and Taxes to Overcome Socio-Economic Inequality

Key Points:

- Poverty and inequality rates are increasing in Indonesia, but at the same time, the number of rich people is also growing.
- Wealth tax was once an alternative applied during the caliphate period to ensure extensive social welfare and justice regardless of differences in background.
- Experts view that Islam recognizes wealth tax through zakat, so the institutionalization of tax and zakat management practices can be performed simultaneously.



The position of taxes and zakat in Islam

In simple terms, taxes and zakat are the obligations of the believers. Taxes are the mandatory and coercive (regulated in law) obligations of citizens to their country. Meanwhile, zakat is the obligation of the believers to donate certain assets based on nature, size, and group, which is why it is important in Islam.

There are two views regarding the position of taxes in Islam. The first view considers taxes and zakat the same. That is, paying zakat means paying taxes, and vice versa. Islamic scholars supporting the permissibility of collecting taxes asserted that they refer to an equitable taxation system in line with Islamic law.

The second view considers taxes and zakat different. Zakat is interpreted as obligatory worship (distinctive worship regulated in the Quran Surah At-Taubah verse 71), while taxes are civil obligations or *muamalat* (worldly matters). Zakat is categorized as "worship" under the dimensions of *muamalat*, morals, and faith. Meanwhile, taxes are categorized as "civil obligations" or "*muamalat*" under the dimensions of morality, worship, and faith. Taxes and zakat are sources of funding to realize *hayah thayyibah* (halal sustenance) and *baldah thayyibah* (a good country inhabited by good people) (Rohman, 2022).

No single view negates taxes with zakat. Therefore, it is possible to simultaneously institutionalize tax and zakat management practices as applied in Malaysia. Zakat management practices in Indonesia differ from those implemented in that neighboring country. In Indonesia, zakat is

managed not only by the state but also by a large number of non-governmental zakat management institutions, including unregistered ones. It means the institutionalization of wealth tax with the zakat system also needs to involve non-governmental zakat management institutions.

Zakat and wealth tax to reduce social and economic inequality

Inequality is a continuously occurring problem in various parts of the world, especially in poor and developing countries. The level of inequality has been exacerbated by the Covid-19 Pandemic crisis. The World Bank (2022), in its 2021 survey, reveals that the number of poor households who lose their income and jobs is slightly higher than that of rich households who experience the same. This trend worsens global poverty and inequality.

Statistics Indonesia (BPS) reported that Indonesia's economy in the third quarter of 2020 experienced a growth contraction of 3.49 percent (year over year/ yoy) compared to the third quarter of 2019. As a result, the number of poor residents in September 2020 reached 27.55 million people (10.19 %), an increase of 1.13 million people compared to March 2020 and an increase of 2.76 million people compared to September 2019 (BPS, 2020). At the same time, according to a global financial institution, Credit Suisse (2021), the number of residents with a net worth of 1 million US dollars or more in Indonesia was estimated to reach 171,740 people in 2020, rising 61.69 percent (YoY) from 106,215 people in 2019.

Efforts to overcome the abovementioned problems certainly require considerable resources. Measures to protect the poor are basically in line with

the core objectives of zakat, as described by Masdar (1993, in Mushthafa and Khunaini, 2020) that zakat is a manifestation of Islamic social commitment to promote justice and prosperity, as well as minimize social inequality.

Referring to the history of zakat, the idea of a wealth tax has been relevant since the caliphate era when there was severe drought and famine, which required additional funding support. Due to this situation, the serving caliph at that time decided to collect zakat of wealth specifically to overcome the crisis. It means that the wealth tax has strong references in Islam and is applicable especially during the Covid-19 Pandemic, where the need for funding to deal with crises in the health, economic, and other sectors is rising. By implementing the wealth tax, the state can ensure the redistribution of excess wealth that accumulates in several people to reduce poverty and inequality, as well as to address other problems.

A wealth tax is imposed on an individual's net worth or the market value of their owned total assets minus liabilities. A wealth tax works by applying a tax rate to an individual's net worth, usually above a certain threshold (OECD, 2018).

Potential and challenges of collecting zakat or wealth tax in Indonesia

Indonesia has quite a high zakat potential, reaching 327.6 trillion rupiahs in 2020 (BAZNAS, 2020). The National Amil Zakat Agency (Badan Amil Zakat Nasional or BAZNAS), in its research, found that zakat, infaq, and sadaqah (ZIS) funds were collected through both official and unofficial zakat management institutions (OPZ) (BAZNAS, 2020).

Zakat in Islam is paid based on two standards: the minimum standard and the virtue standard. The payment of zakat based on the minimum standard is regulated in Islam, and most people only pay zakat according to the minimum standard to fulfill their obligations. Meanwhile, the payment of zakat based on the virtue standard refers to the payment of zakat over the applicable *nisab* (minimum amount). The virtue standard can also be identified as the commitment or willingness of a person to pay zakat more than the required amount when their wealth is much more than their basic living expenses. Zakat can be distributed to eight *asnaf* (groups of people entitled to receive zakat), public infrastructure, and routine government expenditures (Masdar, 2022).

However, trust is one of the most challenging aspects of zakat collection in Indonesia. Many Muslim citizens prefer to pay their zakat independently because they find it easier. It is also because of the public distrust in charity institutions managed by the government. In addition, Muslim citizens have more trust in charity organizations managed by CSOs (such as LAZISNU and LAZISMU). Besides, the level of public awareness to pay zakat through official institutions such as BAZNAS is merely limited to their form of compliance with their obligations as employees in a company or institution, not their personal awareness. The current zakat payment practice is based on the minimum standard, not the virtue standard.

Furthermore, there are three aspects to consider to implement wealth tax: **first**, a new middle-class Muslim

group in Indonesia who perceive religion as an essential aspect of their lives; **second**, people with varied understandings of taxes and zakat, considering some assume that paying taxes will exempt them from paying zakat, and vice versa; people realize that the obligation to pay taxes differs from the obligation to pay zakat, including for the High-Net-Worth Individuals (HNWIs); **third**, HNWIs who need support in managing their wealth as a form of goodwill. A super-rich person may make a donation to build particular facilities credited to them. It can encourage HNWIs to spend their wealth to contribute to community development.

Comparison of zakat funds management in Indonesia and Malaysia

1. Institutional aspect

In Indonesia, zakat is managed not only by the state but also by a number of non-governmental zakat management institutions, including unregistered ones. The Indonesian zakat management system can be characterized as voluntary, meaning that those who do not fulfill their zakat obligations are not subject to any legal sanctions. Law No. 23 of 2011 concerning zakat management regulates two types of Zakat Management Institutions (OPZ) in Indonesia, namely the National Amil Zakat Agency (BAZNAS), which is managed by the government, and the Amil Zakat Institution (LAZ), which is managed by civil society, which are integrated and synergized in the process of collecting, managing, and distributing zakat. BAZNAS and LAZ are available from the district/city level to the national level. However, apart from these official institutions, many people also pay their zakat through informal zakat management institutions, such as mosques near their residences.

Meanwhile, the zakat management in Malaysia is unique among various countries in the Southeast Asian region. The authority of zakat collection and distribution in Malaysia is controlled by each region. As a result, the regions in Malaysia implement varied zakat management. These diverse models of zakat management policies lead to a wide range of problems corresponding to the coordination of the *nisab* amount, classification of eligible assets to be subject to zakat, and individuals entitled to receive zakat (*ashnaf*) (Islamy & Aninnas, 2020).

2. Policy framework aspect

The Government, through Law No. 36 of 2008 concerning the Fourth Amendment to Law No. 7 of 1983 Concerning Income Tax, stipulates that the payment of zakat to official institutions approved by the Government can be a deduction from the income that will be taxed. Furthermore, the implementation of zakat as a tax deduction in Indonesia has also been regulated in Law No. 23 of 2011 concerning Zakat Management in Article 22 and Article 23, paragraphs 1 and 2. Article 22 states that the zakat paid by *muzakki* (eligible individuals to pay zakat) to BAZNAS or OPZ is deducted from taxable income. Then, BAZNAS or OPZ shall provide a zakat payment receipt to each *muzakki* as proof to proceed with deducting their taxable income. The policy on zakat as an income tax deduction aims to

prevent Muslim taxpayers from being exposed to a double burden and increase public awareness to pay zakat as their obligation as Muslims. However, not all workers in Indonesia are formal workers and have been registered as taxpayers.

The correlation between taxes and zakat in Malaysia can be perceived from the country's regulation, which stipulates that paying zakat can release individuals from their tax obligations. Muslims in Malaysia manage to benefit from the tax deduction equivalent to paying zakat. Zakat can be used to reduce taxes by up to 100%. This strategy aims to avoid the payment of double taxation on the income of zakat payers or muzakki. However, it is essential to note that *muzakki* must pay their zakat to an official

zakat institution recognized by the state, such as Pusat Pungutan Zakat (PPZ) or Zakat Collection Centre (Islam & Salma, 2020).

3. Compliance aspect

The compliance aspect also influences the potential for receiving zakat. The data demonstrated that the average acceptance of zakat in Indonesia was low compared to Malaysia. Based on the 2019 data, the average payment of zakat in Indonesia amounted to IDR1,161,431 per year/individual. Meanwhile, in the same year, in Malaysia, the average zakat payment was IDR10,198,045 per year/individual.

Table 1. Zakat Collection Statistics in Indonesia and Malaysia

Details	Indonesia		Malaysia	
	2018	2019	2018	2019
Zakat acceptance (in billion rupiah)	IDR8,117.60	IDR10,227.94	IDR2,054.1	IDR2,151.9
Registered zakat payers (individuals)	8.2 million	8.8 million	180,958	211,012
Average payment of zakat (rupiah)	IDR989,939	IDR1,161,431.8	IDR11,351,363.3	IDR10,198,045.6
GDP Per Capita (in million Rupiah for the entire population)	IDR56.4	IDR59.1	IDR164.8	IDR158.9

Source: processed from BAZNAS, PPZ, BPS, and World Bank

Note: The calculation results of the total zakat acceptances in Indonesia have the following details: zakat al-mal for individuals, corporate zakat, zakat al-fitr, infaq/alm and CSR, and other social religious funds. Meanwhile, The calculation results of the total zakat acceptances in Malaysia have the following details: zakat on income, zakat on trade items, zakat on savings, zakat al-mal, zakat qada (paying zakat that has not been paid in the past), and others.

Zakat collection in Indonesia remains not optimal. The analysis by Baznaz (2021) found that the realization of zakat only reached IDR71.4 trillion or about 21.7% of the potential zakat, amounting to IDR327.6 trillion. Of this amount, only IDR10.2 trillion was paid through the official OPZ, Baznaz, while the remaining amounts were paid through the unofficial OPZ. In addition, Indonesian people have not fully made the payment of zakat a personal awareness since the obligation of zakat is a religious obligation.

Meanwhile, zakat institutions in Malaysia have improved, especially regarding zakat collection. The improvement in zakat collection is also caused by several factors, such as the existing policy that obliges zakat for Muslims and the zakat collection through e-zakat. Most zakat institutions in Malaysia have begun to develop e-zakat, a web-based application that provides zakat information electronically (Hairunnizam & Radiah, 2008).

Conclusions and Recommendations

Integrating the concept of zakat and wealth tax into the national financial system is the essence of formulating the role of religion-state relations in solving social development problems. Islamic scholars supporting the permissibility of collecting taxes asserted that they referred to an equitable taxation system, which is in line with Islamic law. The second perspective considers that taxes and zakat are

different. Despite the different statements among experts in Islamic law regarding the correlation between zakat and taxes, there are no contrastive aspects between taxes and zakat; thus, both can be integrated. Regardless the wealth is distributed through the state (as wealth tax) or the amil zakat institutions (as zakat), it will be allocated for people's welfare.

The followings are recommendations proposed::

- **Increasing the transparency of the collection and distribution of zakat.** The Ministry of Religious Affairs, the Zakat Management Institutions (OPZ), and the Amil Zakat Institutions (LAZ) need to improve the transparency of the collection and distribution of zakat. The distribution of zakat to *mustahiq* (individuals entitled to receive zakat) must be supported by an accurate database to avoid overlapping acceptance.
- **Developing innovation and digitization of the zakat collection, especially to make it easier for muzakki to fulfill their obligations.** BAZNAS needs to develop strategies and innovations for collecting zakat for *muzakki* and reporting it to BAZNAS easily, where the report becomes part of zakat acceptance and as proof of official tax deductions.
- **Building a mechanism for the integration of taxes and zakat opportunities as well as the implementation of wealth tax.** It is necessary for the Ministry of Religious

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Affairs and the Ministry of Finance to work together to manage and allocate zakat for development and poverty alleviation. The Ministry of Finance shall recognize the legality of paying zakat on assets deposited by individual taxpayers (WP OP) to the Amil Zakat Institutions through BAZNAS or registered religious

organizations. Thus, WP OP can pay wealth tax through the payment of zakat to registered zakat management institutions. The zakat payment receipt shall be considered evidence of wealth tax payment reported through filling out the Annual Tax Return (SPT).

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