

## ***ISSUES OF TAXATION IN AN ISLAMIC ECONOMY***

*\*Bibi Fozia*

*\*\* Noor P. Khan*

### ***Abstract***

*Taxation policy is an important source of revenue for government in the conventional and Islamic economy now a days. But the question arises that taxation policy is according to Islamic shariah or not. This paper discussed imposition of taxes according to scholars Imam Malik, Ibn Hazm , Al-Ghazali and Ibn Khaldun. Also examines types and principals of taxation in Muslim states.*

*By defining the determination of the taxpayers and the tax procedures it is concluded that taxation policy beyond zakah is un-Islamic.*

*This paper discussed Al-Ghazali's five necessary Shariah-mandated foundations of individual and social life: religion, life, family, property, and intellect and his focus on the economic aspects of maslaha (social utility), distinguishing between necessities, comforts and luxuries. Scholars argue that to obtain higher tax revenue, it is necessary to lower the tax rate. The Islamic state must have to follow the rules set by Prophet Muhammad (peace be upon him) for its economic, political and social relations among people on the basis of: "What is lawful is clear and what is prohibited is clear."*

*Therefore, the Islamic state cannot impose economic and political priorities; it must follow the guidelines provided by Shari'ah.<sup>1</sup>*

*Many opinions and ideas are presented in the modern Islamic literature in attempts to define the role of the Islamic state, in general, and its economic function in particular. The following three are the most important:*

*The bases of the Islamic state are welfare. The prosperity of the lower socioeconomic strata is its priority.*

*As the Islamic state is a development state, economic growth plays a predominant role in shaping the state's policy.*

*The Islamic state is responsible for social and economic justice. Economic policy is developed with economic balance and equilibrium in mind.<sup>2</sup>*

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*\*MS (Economics), and Visiting Lecturer at International Islamic University Islamabad,*

*\*\*Professor Institute of Development Studies, The University of Agriculture, Peshawar, Pakistan.*

AL-Ghazali defines welfare as: "The purpose of *Shari'ah*, as far as people are concerned, is fivefold: The protection of their life, religion, property, mind and offspring. Thus anything that promotes these five (or any of them) is *Maslahah* (interest) and anything that implies damaging them is *Mafsadah* (harm). Thus, the Islamic state has duty to ensure the following:

1. To eliminate poverty
2. To create opportunities for full employment and economic growth
3. Maintenance of law and order
4. To provide economic and social justice
5. Establish equitable distribution of wealth
6. To promote international relations and guarantee national defence

The former goals have been taken from the Qur'an and *Sunnah* and were in place during the socio-economic system present during the Prophet's (peace be upon him) lifetime and the Caliphate.<sup>3</sup>

#### **Sources of Revenue of the Islamic state**

The Islamic state derives revenue from Kheraj , Jazia , Voluntary Contributions, zakah and sadaqat, property and assets without heirs, whose owners could not be found, and those awqaf (charitable donations or trusts).<sup>4</sup>

#### **Al-Ghazali's point of view of the sources of revenue**

(Ghazanfar & Islahi, 1997) Al-Ghazali identifies several sources of revenue, but is critical of some sources as not being lawful islamically and others which are permitted in *shariah* as not being used; valid sources like *zakah*, *sadaqat*, *fai*, and *ghanimah* are non-existent. If they are present, methods of collection are highly suspect.

#### **Justification for imposing additional taxes**

In conclusion to the above discussion, we find support for the right of Muslim governments to levy additional taxes. However, Islamic scholars are cautious in pursuing clear and appropriate justification for taxes. They want to ensure that these are to the advantage of the people rather than the rulers. This is due to the import of private property in Islam. No one, not even the state, is permitted to take anyone's private property except with strong and clear justification for doing so. Public concerns take priority over private concerns; once it has been recognized that people's interest can be served by a particular tax, taking private property becomes permitted. Generally, justification for imposing taxes may be as follows:

1. Security, e.g. the budget of regular and emergency forces at times of war and peace to the limit that these provide safety and security of the religion, Muslim land and people.
2. Current revenue required for political and judicial activities and the safeguarding and promotion of the ideological and ethical values of Islam.
3. The maintenance of a socially determined subsistence i.e, essential food, clothes, and shelter for all people in the Islamic state.

4. The development of capacity of production in the state, sufficient to deliver the survival for living.
5. Assistance of social, economic and psychological stresses causing from natural disasters such as war or earthquake or any other emergency.<sup>5</sup>

### **Example of tax imposition from history**

Umar imposed a tax on, non-Muslim merchants reciprocal to that levied by non-Muslims on Muslim merchants. He executed a tax at the rate of 10 per cent on fibers and 5 per cent on items of food. In order to increase supply of food items in Medina, he kept a lower rate on food items.<sup>6</sup>

### **Types of taxation in Muslim states**

Modern taxes applied on income, wealth, land, public enterprises, user charges, fees and domestic transactions in practice may not be consistent with Islamic *Shari'ah*. Ibn Khaldun has mentioned to sales taxes and market fees imposed on urban areas. Taxes on retail sales may be better than many other forms of indirect taxes. Such taxes are found to have elastic revenue yield, little distortions to distribution channel or to resource allocation, and little excess burden on consumers as compared to other forms of indirect tax.<sup>7</sup>

### **Principals of taxation**

Taxes can play key role in today's Muslim countries whether poor or rich. The structure of taxation must meet economic efficiency and equity in revenue and administrative criteria. Certain essential principles for the tax structure are as follows:

1. Taxation should decrease unnecessary consumption for poor countries and should enhance capital development. In rich states it is essential to cut lavish consumption and reduce consumption of several goods which are harmful to health.
2. Taxation may play an important role in reallocating resources from less beneficial growth project to those having greater benefit for development.
3. A progressive tax system may help in decreasing inequalities in income and attaining social harmony in Muslim states.
4. Firms contributing most of economic growth should subject to minimal burden of taxation on profits.
5. The structure of taxation must conform to known criteria of equity and ability to pay.<sup>8</sup>

### **Imposition of taxes according to scholars**

#### **Imam Malik**

"If there were no resources in the treasury or the funds are needed for defense of the country, the government has the right to impose taxes on the rich to overcome that need until the revenues of the treasury appear". Imam Malik mentioned five important conditions for imposition of taxes: (a) regular revenues are exhausted (b) defense expenditures exceed existing resources (c) taxes are imposed temporarily (d) the

amount of taxes taken should not exceed needs (e) taxes are imposed on the rich only.<sup>9</sup>

### **Ibn Hazm**

Ibn hazm restricts tax imposition to the case where Zakah earnings are not enough to fulfill the needs of poor. According to him, the poor people “should be given the essential food and clothes and a shelter.”<sup>10</sup>

### **Abd al-Haiy al-Kattani**

He says salaries of military workers, students and researchers in *Shari’ah* studies, and teachers should be given by the treasury. In case of lack of its funds, taxes can be imposed for such purposes.

### **Al-Ghazali**

Define the principle of imposing taxes, beside those clearly authorized by the *shariah*:

1. The taxes can be imposed in the benefits of public welfare and defense of the Islamic state. When there is a shortage of funds in the treasury of the state, survival and the security of the nation may be at stake. The ruler has the right to enforce additional taxes to face such situations.
2. The taxes can be imposed for improving and/or protecting the property of the orphan. The state as the protector and guardian of the orphan may enforce taxes which will enhance the orphan’s overall well-being.
3. Al-Ghazali supports *maslahah*-based flexibility with respect to taxes. Al-Ghazali says that “greater loss could be avoided by facing a smaller one” for example people paying in taxes must be less than the risk to their lives and property.
4. According to al-Ghazalai , the system of “taxation was in fact established upon traditional customs, not upon *shariah* As there are many types of taxes collected from Muslims for example seizure of property and bribery -- all illegal revenue sources.”<sup>11</sup>

### **The determination of the taxpayers and the tax procedures**

In the light of saying and practices of Companions and great scholars, derived the following principles:

1. In order to determine the payees of taxes, other than those clearly mentioned in *Shari’ah*, we find three main principles:
  - a. The financial capability is a basic measure in defining tax liability. Taxes may not be levied on those having "adequate" resources of living, i.e. above survival but below the rich class. Taxes are only executed on the rich and inasmuch as they can afford.
  - b. Taxes on bonus profit and bonus capital gains may be executed particularly in circumstances where the possibility of political or economic exploitation is involved.

- c. Custom duties on foreign traders may be executed, particularly when the entry of foreign merchandise is administered by agreements requiring such duties on mutual grounds.
2. In order to determine the tax assessment and collection, find two main principles:
  - a. The assessment of all types of taxes should be just and easy. Neither the payee nor the assessee should be harmed in any way.
  - b. The burden of the taxes must be distributed among the equals. A careful study of incidence shifting must be made in order to avoid injustice in the distribution of the burden of the nation's funds.<sup>12</sup>

### **Taxation policy beyond *zakah* is un-Islamic.**

1. Any obligatory state charges or taxes is unjust due to the sanctity of private property recognized by Islamic Shari'ah.
2. In an Islamic economy it is argued that a clear difference must be made between the subsistence welfare and the desired welfare of people. It is obligatory for the state to provide subsistence level whereas the provision of an adequate standard of living is only desired.
3. Subsistence category includes aids and services given to people stricken by a natural calamity, war, famine or lack of production to below subsistence level etc. The desire category includes social services designed at improving the living standards.<sup>13</sup>

### **Difference between the tax and *zakah***

#### **Progressive Taxation**

1. Progressive taxation is one of the important measures for alleviating unemployment. Progressive taxation is not, however, a panacea for unemployment.
2. All the money collected in the form of progressive taxation from the rich cannot be given directly to the poor, although this can be done to *some extent* in the form of relief payments and pensions etc. The government which collects taxes for purposes of redistribution must either subsidize private citizens or expands the scope of its activities for education, medical care in order to provide social services for lower-income groups. But such services provided by the state do not enable the low-income groups to become self-sufficient.
3. If progressive taxation increases the society's propensity to consume at the cost of weakening the incentive to invest, the harms in employment from the latter may more than cancel the benefit from the former.<sup>14</sup>

#### **Zakah**

1. *Zakah* is one of the foundations of Islamic doctrine *and* a religious tax. Its collection is independent of the economic conditions of the society in Islamic state.
2. *Zakah* has a broader base than taxation; it is levied not only on returns but also on idle wealth.

3. The earnings of *Zakah* goes directly to the poor and needy and play an important role raising the tendency to consume.
4. Although, In the Holy Quran we do not find any prescribed form or ratio of the tax of *Zakah* but in the sunnah of the Prophet (peace be upon him) we find certain ratios on different types of incomes and assets. These ratios are fixed and unchangeable to achieve economic objectives.
5. Not only are the ratios fixed but the purposes for which the earnings of the tax can be used are quite clear. These purposes are detailed in the Holy Qur'an in Chapter 9, verse 60. The proceeds shall be assigned to: (1) the poor, (2) the needy, (3) the officials over them, (4) those whose hearts are made to incline (to truth), (5) the (ransoming of) captives, (6) those in debt, (7) those in the way of God, and (8) the wayfarer (H. Ahmed, 2004; Z. Ahmed et al., 2008; Qardawi, 2009)
6. It must be considered a fiscal measure. The authorities cannot use zakat as a fiscal tool to achieve economic goals
7. These limitations clearly show the superiority of the Islamic economic democracy and equality. They also show the superiority of the tax of *Zakah*, introduced over 1400 years ago, to the measures of progressive taxation introduced by Keynes.

### Effect of *Zakah* on Consumption

(Avi-Yonah et al., 2007) There are two major effects of *Zakah* on total consumer expenditure in an Islamic economy. Firstly, due to *Zakah*, both the average and the marginal propensities to consume would be higher in an Islamic economy than in a non-Islamic economy. Secondly, due to *Zakah*, the investment gap at each level of income would be smaller in an Islamic economy. The effect of *Zakah* on consumption is shown in Figure 1.

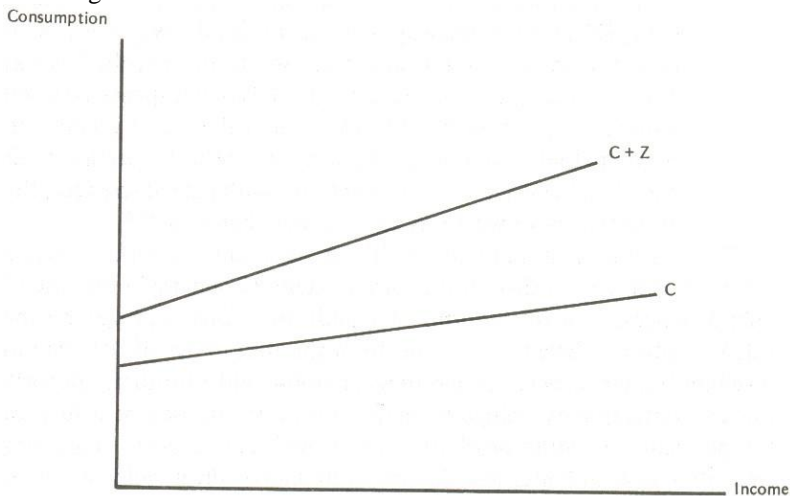


Figure 1: Effect of *Zakah* on the Consumption Function

C = A consumption function without *Zakah*

C+Z = A consumption function with *Zakah*

### **Suggestion to improve taxation policy**

1. Taxation policy in the Islamic state will be intended to compensate or fill the 'resource gap' arising out of or incidental to *zakah* and *sadaqat*.
2. Taxation policy in the Islamic state will be so organized as to fill in the 'objectives gap' indicated by or incidental to *zakah*.
3. *Zakah* is an allocated tax, and state may have other goals to attain for which *zakah* earnings cannot be used, it will have to levy other taxes.
4. For this purpose if any of the Western principles of taxes imposition is compatible with Islamic morals, there is no harm in using them.
5. The ability to pay taxes must be a fundamental consideration, not only restricted to rich.
6. The Islamic state can also impose some taxes on the poor to stop unnecessary consumption; they will be mostly corrective taxes and not necessarily revenue raising taxes.<sup>15</sup>

### **Summary**

There is an clear injunction to the Ummah that the wellbeing of people in the life of this world and success in the life hereafter is the core of the *maqasid al-shari'ah*.

There is no difference of views among scholars that giving minimum subsistence for the people is obligation of the Muslim state. Now the question arises to provide minimum subsistence is through charity or creating economic opportunities for the people to facilitate them to meet their needs by themselves? Islamic state does not want people to be dependent on charities forever. So, creation of economic opportunities through productive jobs so that people can make an decent living is a extremely required aim of Islamic state. Correspondingly, poverty cannot be removed in the long run unless economic development rises the size of the cake.

Most of the Muslim scholars are of the view that an Islamic state can levy additional taxes to achieve its duties towards God as well as towards its people. According to Malik, Ibn Hazm, and Kattani, tax imposition over and above *Zakah* is justified in cases of defense needs, assurance of a minimum living of the poor and the essential expenditures that protects the Muslims interests. These scholars did not state any development, equilibrium and welfare activities for levying taxes nor do these objectives of the Islamic state find any explicit or implicit justification in the texts of Qur'an or Sunnah.

So in conclusion, in the Islamic state, it is extremely important to determine circumstances and conditions of tax imposition in a clear way. Therefore, two important conditions that must be kept in mind while imposing taxes: first the kind and urgency of necessities, and second, the alternatives available to achieve these necessities.

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