

Zakat versus Taxation as Islamic Fiscal Policy Tool: Challenges and Way Forward

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Abstract:

Linking Islamic instrument like zakat with social responsibility and economic growth is an area which is often unspoken. As such, this research intends to find out the potential challenges zakat can face while it is used as fiscal policy tool which has link with Islamic socially responsible financing to economic growth to poverty alleviation mentioning few. Though many Muslim based countries using Tax as an alternative tool for government earning, zakat as a tool has broader spectrum from having impact on economic development to the role as an instrument for Islamic socially responsible finance. This research uses qualitative paradigm to analyze the literature. The research is based on a desk-based research with findings that there are challenges to establish zakat as prescribed in the revealed text which can be minimized through different actions. It is projected that properly executed plan to manage zakat could be used as an instrument of fiscal policy as well as an Islamic socially responsible financing instrument.

Keywords: Islamic finance, Tax, Zakat

A. Introduction

Shah, A. (2013) in Poverty Facts and Stats presented the statistics from the World Bank that almost half the world over three billion people live on less than \$2.50 a day, 640 million live without adequate shelter, 925 million people suffer from hunger, 400 million have no access to safe water, 270 million have no access to health services, 1.6 billion people a quarter of humanity live without electricity, 10.6 million died before they reached the age of 5 which is same as children population in France, Germany, Greece and Italy and 1 billion are illiterate. Muslim countries are not exceptional, 351.2 million people are living on less than \$1.25/day. The reason for mentioning these figures is to connect to the fact we are living today. The same source (Shah, 2013) also mentions that much of the poverty reduction in the last couple of decades almost solely coming from China where poverty rate fell from 85% to 15.9%. Thus, we can say we are failing in many areas to provide minimum living requirements. With other economic agents, government and members of the society have parts to play in this development role if we assume current government level policy tools are not sufficient, thus we need to go back to history and revive some instruments which are distinctive to Islamic economy and zakat is one of those. Objective of this paper is to find out through qualitative analysis the challenges zakat faces as Islamic fiscal policy tool compared to traditional tax as there should be sufficient reasons to mitigate them through possible ways.

B. Literature Review

In this part of the paper the history of *zakatis* discussed along with taxation as a fiscal policy tool, in addition, their major comparative differences are also discussed which make it easier to shed light on *zakatas* an alternative of traditional method to achieve desired macroeconomic objectives like social justice by the side of economic growth as Malik (2016) described social justice and economic growth are correlative terms. The material development of any human society is impossible until it has a strong and sustainable economy that, in turn, is strongly rooted in the concept of social justice. Material progress of any human civilization is impossible unless it has a robust and sustainable economy, which is firmly founded in the principle of social justice (Malik, 2016).

1. History of Zakat

Zakat may gradually acquire acceptance in the modern world as the most perfect and practical way for assisting the poor and needy in current society (Billah, 2016) but the rulings must be rooted from the *shariah*, a firm historical background will smoothen the overall understanding. In *Shari'ah* the word *zakat* refers to the determined share of wealth prescribed by God to be distributed among deserving categories (Qardawi, 1988). As of the very basics, *zakat al-fitrah* and *zakat al-maal* are the two types of *zakat* where *zakat al-fitrah* is paid at the end of the month of *Ramadaan* and *zakat al-maal* is the *zakat* on wealth. The purpose of *zakat al-fitrah* is so all poor and needy can have food at the *Ramadaan* end celebration whereas *zakat al-maal* is on wealth not income, moreover not all types of wealth are considered for *zakat*. Those types on which *zakatis* imposed need to reach a minimum level (*nisaab*). In addition to this, the eight categories of recipients of *zakat* also mentioned in the Qur'an explicitly. *Zakatis* payable once in a lunar year and flexible on the person on exact point of time of the year it is paid except for the kind of wealth is gained from the earth (e.g. agricultural produce) for which *zakatis* paid at the time of harvest or extraction.

Before the Time of the Prophet (peace be upon him). If we explore the history, *zakat* has similar background like *salah* (prayer) as both had existence before establishment of Islam by last Prophet Muhammad (peace be upon him). "When the Almighty Creator asked the Muslims to pay it, it was not something unknown to them. All the followers of the religion of Ibrahim (AS) were fully aware of it" (National Zakat Foundation, 2020). It was a known *sunnah* for monotheists which continued with divine revealed restructuring. There are sufficient evidences from *Qur'an* which confirm its existence in pre-Prophetic era on the other Prophets.

Zakat of Prophet Isma'il (may Allah be pleased with him): "And mention in the Book, Ishmael. Indeed, he was true to his promise, and he was a messenger and a prophet. And he used to enjoin on his people prayer and *Zakat* and was to his Lord pleasing [i.e., accepted by Him]." (Al-Qur'an 19:54-55). *Zakat* of the Jews: "And [recall] when We took the covenant from the Children of Israel, [enjoining upon them], "Do not worship except Allah; and to parents do good and to relatives, orphans, and the needy. And speak to people good [words] and establish prayer and give *Zakat*." Then you turned away, except a few of you, and you were refusing." (Al-Qur'an 2:83) *Zakat* to the progeny of Prophet Ishaq Prophet Yacob (may Allah be pleased with them): "And We made them leaders guiding by Our command.

And We inspired to them the doing of good deeds, establishment of prayer, and giving of *Zakat*; and they were worshippers of Us.” (Al-Qur'an 21:73). *Zakat* of Prophet Isa (may Allah be pleased with him): “He said: Lo! I am the slave of Allah. He has given me the Scripture and has appointed me a Prophet. And has made me blessed wheresoever I may be and has enjoined upon me *Salaah* and *Zakat* so long as I remain alive.” (Al-Qur'an 19:30-31)

Era of the Prophet (peace be upon him). If we study *zakat* and its application at the time of last Prophet Muhammad (peace be upon him) from History of *Zakat* retrieved from National Zakat Foundation (2020), the impact on the society whether it is spiritual or economic can be realized to the best extent in addition to the process of implement in the society. While the *ayaths* (verses) of the *Qur'an* revealed in Makkah were basically voluntary payments, after *hijrah* (migration to Madeenah) the revelation came in form of obligation. Before *hijrah* the duty was based on individual faith and *taqwa* and sympathy as Surah Al-Ma'arij (70:24-25) recommends: “And in whose wealth there is a right acknowledged. For the beggar and the destitute.” In the following year after *hijrah*, *zakat* established as an obligatory religious duty on the Muslims when Prophet (peace be upon him) started to have workers for collection and distribution of due *zakat*.

From established Islamic *Shari'ah* we know that some of the rules are in *Qur'an* are expressed in brief following the main objective is to establish the principle, then the details we get from the words and actions of the Prophet (peace be upon him). In case of *zakat*, it is *sunnah* of the Prophet (peace be upon him) that gives us the details of the process, measure, items required to pay *zakaton*, exempted people, etc. This way the theoretical axiom of the *Qur'an* is implemented into a living reality. The Prophet (peace be upon him)'s *sunnah* gives us detailed descriptions of the types of *zakatable* wealth, the minimum exempt of each of them and the applicable rates as well as the details of the categories of people who are eligible to receive *zakat*. (National Zakat Foundation, 2020).

Post Prophetic Era. Different rates of *zakaton* different items observed and deduced from to the *Qur'an* and the *Sunnah* of the prophet Mohammad (peace be upon him). Some details about the rates and types of *zakat* were altered at prophet's companion's timeline which include *zakat* from livestock, *zakat* from gold silver and jewelry, *zakat* from honey and products from animals, and *zakat* from mineral and assets received from the sea (Hayeeharasah, Sehvises, & Ropha, 2013). The rate for *zakat* for banknote was fixed in the era after the companions, which was not occurred before this period (Hayeeharasah, Sehvises, & Ropha, 2013).

2. History of Tax

As per the research of Northeastern University if we go back to history first record of organized taxation comes from Egypt around 3000 B.C. There are numerous historical sources including the Bible Chapter 47, verse 33 of the Book of Genesis expresses the tax collection practices of the Egyptian kingdom. It elaborates that the Pharaoh would send

commissioners to take one fifth (1/5) of all grain harvests as tax. William D. Samson (2002) says tax has blurry historical origin stating that first institution is unidentified as of poor historical records as well as of cultural and societal structure of ancient empires where leaders were viewed as gods as people as their property. Going back to the research by Northeastern University, the tax system got complex in the second half of the 20th century when there was developments and extension of welfare programs like Social Security, Medicare and Medicaid, with which government had more roles to play, but as inevitable there was growing resistance to practice as well. "Organized resistance and legal protest against the income tax coalesced in the U.S. in the 1950s and continues today" (Northeastern University, 2020). Thus, this is not wrong to say the whole taxation practice is always under revision having different regional practice worldwide, in addition in mind of the members of the society it might not be perfect as we can assure continuity of these debates and resistance globally. As taxation has surfaced from practical financial need, it is expected to be practical on the payers as well.

3. Zakat And Tax Comparative Differences

Mark Horton and Asmaa El-Ganainy (2020) from International Monetary Fund discusses fiscal policy and its impact stating that the utilization of government spending and taxation to impact the economy is known as fiscal policy which is often used by governments to foster robust and sustained growth while also reducing poverty. The goal of fiscal policy includes economic growth, employment, economic stability, equitable distribution of income and wealth, and justice by allocation, distribution, stabilization, and growth in a country's economy using tools of governmental expenditure and revenue. There are three main positions in government's deliberate fiscal policy: neutral, expansionary, and contractionary. (Saad & Foori, 2020)

In short, neutral fiscal policy is generally embarked on when an economy is in stable as government expenditure is covered by government revenue. There is a stable environment overall in the economy through the budget activities. Expansionary fiscal is on work while there is recession in the economy and the policy involves government expenditure topping revenue to fix the condition, on the other hand, contractionary fiscal policy is undertaken to avoid inflation, this policy increases tax and lowers government spending (Abdullah, et al., 2018). This excess balance can be used to neutralize government debt. If we compare this with an Islamic framework, "An Islamic economy has all the fiscal instruments of conventional economy that is government expenditure and taxation alongside a unique tool known as *zakat*" (Abdullah, et al., 2018).

When we compare *zakat* and tax, many significant differences can be visible between these two fiscal policy institutions, for example, while *zakat* is a religious duty, tax is a legal duty towards own country. Only Muslims are obliged to pay *zakat* but tax is paid by all working citizens based on their earning level (normally either proportional or progressive tax), which brings another factor that *zakat* is paid on savings not income in addition to business goods, agricultural produce, gold, silver and minerals but tax is only imposed on

the income from various sources and tax doesn't consider savings. This means that *zakat* is imposed on the compilation of wealth (specific types) irrespective to current earnings and the wealth must be in possession of one lunar year which is not a requirement for certain types of tax, in addition, tax is only applicable on the income detected in system irrespective to the savings one has. (Abdullah, et al., 2018)

Rate of *zakat* and minimum level of it are fixed by *shari'ah* which is not changeable by any government, on the other hand as we know from history of tax, it is subject to review and varies from time to time as mentioned by Abdullah, et al. (2018). To whom *zakat* must be distributed and who cannot receive it (discussed in next section) all are explicitly mentioned in the *Qur'an* and cannot be altered or distributed otherwise, whereas tax is used all types of government expenditure and there is no limit on this area. Provided the differences, tax and *zakat* can be used side by side or alternatively, point to note that in Islam everything belongs to Allah who wants us to purify His given wealth to us as trust by paying *zakat* which is a pillar in Islam and obligation on every eligible Muslim. Therefore, it is important to know the challenges of *zakat* because by paying tax Muslims will not be exempted from this religious duty which brings us to the bottom line that *zakat* should be used as the fiscal policy tool which will not only fulfill our obligation but also act as government revenue source, in addition, it will be a reason to receive *barakah* (blessings) from our Creator, besides, *zakat* has humanitarian and socio-political value being philanthropic in nature.

C. Result and Discussion

1. Discussion on Challenges Of Zakat

From revival and collection perspective in many countries, *zakat* has become a personal religious duty which is subject to own choice to pay or not and in turn the whole mechanism became very unorganized which is far away from centrally managed *bayt al-zakat* in the era of our Prophet (peace be upon him). This is now a challenge to revive the whole process as it is in theory and as it was in practice initially. Though *zakat* is a fiscal policy tool, in current time it is hard to switch to *zakat* suddenly in countries where tax is exercised. It needs awareness from government level to personal level, moreover, only awareness won't be sufficient, following a proper transition, there will be need of effort to implement and hold the process to utilize the tool for desirable economic growth and social justice.

The challenge *zakat* has compared to tax in case of management and distribution is that the beneficiaries of *zakat* must belong to eight specific categories mentioned in the *Qur'an* which is not the case for tax. Chapter nine's verse sixty of the *Qur'an* mentions:

"Alms is only for the poor and the needy, for those employed to administer it, for those whose hearts are attracted 'to the faith', for 'freeing' slaves, for those in debt, for Allah's cause, and for 'needy' travelers. 'This is' an obligation from Allah. And Allah is All-Knowing, All-Wise."

Thus, this is a challenge for the authority to manage and distribute properly ensuring *zakat* is only received by the categories of people mentioned in the sacred text. Another crucial point here is, scholars defend that some groups who cannot receive *zakat* – public facilities like bridge, highway or mosque (there is exception for mosque, can be used for those who live in a non-Muslim country or where Islam of a poor society is endangered by missionaries), affluent Muslims, Muslims having capability to work and cover their basic necessities, non-Muslims (except needy to fulfil basic needs as in famines), children, father, mother or wife of the person paying *zakat*, and finally the family of the noble Prophet Muhammad (peace be upon him). (Abdullah, et al., 2018)

Aforementioned issue brings us to another challenge that management authority has to confirm no *zakat* ends at these groups of people. In addition to this eligible individual should receive what amount determining that effectively is another challenge of the authority. Overall, the challenge is to administer this institution and to appoint right people in collection and distribution and proper management of *zakat* funds. The appointed parties must take accurate account of all transactions and for their services they are allowed to be paid wages from *zakat* funds itself.

2. Way Forward

We have seen in literature review section that *zakat* is rooted with the existence of human being on earth which was practiced by people of other Prophets came before the last Prophet (peace be upon him), which indicates *zakat* is not new addition to economic policy rather this is a revival of an ignored policy. Historically *zakat* was managed by *Bayt al-zakat* which was under *Bayt al-maal* and supervised by head of state or government, though we cannot have this arrangement instantly everywhere "still *zakat* can be a major source of funds to encourage community economic empowerment and equal distribution of resources" (Abdullah, et al., 2018) which can work on poverty as well as social justice even in current world taking lesson and example from successful ones. From transition perspective, Malaysia is an excellent example bringing *zakat* with tax rebate. Employees can choose to pay *zakat* and reduce individual income tax. Sometimes people use charity or donation to lower the taxable income but cannot escape from it. In that case tax rebate through *zakat* is an excellent tool to reduce tax amount not taxable income, in addition this practice can help people to switch slowly to pay *zakat* instead of tax.

There is a difference in tax relief and rebate applied here. Contributing to *zakat* has the extra benefit of functioning as a tax rebate for one's annual income taxes. As per RinggitPlus (2021) which is Malaysia's leading financial comparison website a tax rebate is a decrease in the amount of income tax you must pay, as opposed to a tax relief, which just reduces your chargeable income amount. Furthermore, the amount of tax rebate you can claim for *zakat* is limited to the maximum amount of tax levied. All of this means that *zakat* payments can significantly lower the amount of income tax individuals pay. In fact, this rebate might sometimes be sufficient to decrease one's income tax liability to zero. Here's an illustration from Ringgit Plus (2021). Let's assume that after all tax reliefs and deductions,

the tax amount is 450 dollars, and that individual has paid 500 dollars in *zakat* in the same assessment year. Because there is permission to deduct the amount of tax refund for *zakat* up to the maximum amount of tax paid, the amount needed to be paid is decreased to zero. This is just a practical example of transition from tax to *zakat* which can be considered in places with similar struggle.

Islam doesn't focus on material welfare, rather it focuses one submission to Allah and take His prescribed way of life so that peace and tranquility can be achieved. On the other hand, conventional economics focus on material welfare. "Islam does not separate spiritual life and economic life" (ISRA, 2018). "Zubair Hasan (1998) prefers a 'step-by-step' approach whereby 'the process of Islamization in Islamic Economic theory building may take conventional economic theories in manageable segments in the same vein: it can be sifted, pruned and modified, where possible, to conform to the *Shari'ah* tenets' " (ISRA, 2018). A sudden negation of tax as a whole might trigger the economy to collapse. Therefore, a transition period can be taken to give option to the population that they have to pay tax and they can *zakat* as well. Later they can be offered to choose between tax or *zakat*. At the end they can be asked to pay *zakat* only. This is how conventional economics can help to formulate Islamic economics policies in Muslim countries. (Djarmiko, 2019)

As *shari'ah* already have the categories of recipients of *zakat*, which is unchangeable, also some parties cannot receive *zakat* fund (discussed earlier), *zakat* fund is not adequate to carry out all the activities which need government spending. (Islamy & Aninnas, 2020) Therefore, there is need for other institution like *waqf*, as well as other sources of government revenue like *jizyah* (tax on non-Muslim adults living in Muslim state), *sadaqah* (voluntary charity), *'ushr* (a type of commercial or business tax), *kharaaj* (tax on agricultural land), etc. *Waqf* is very important tool here which is emphasized by *shari'ah* having a broad area of research and implementation. Without supporting of other tools, transition to *zakat* system won't be easy or can assume won't be possible. Proper training to administer, collect, distribution is needed to right parties, besides there is a need for spiritual training. Normal Muslims are in need of spiritual training so that they will come forward to pay own due and participate in their religious duty which will serve as socially responsible act as well. Transparency in management is also needed as there is a restriction of benefitting parties, which *zakat* management authority needs to ensure.

3. Zakat As Tool For Economic Development

Qardawi (1988) mentions the goal of *zakatas* not only a temporary solution to the poor's urgent needs and to alleviate his agony, returning him to poverty in the long term. *Zakat* aspires to eliminate poverty and make the impoverished self-reliant by providing them with sufficient financial means to enable them to work and produce for their own subsistence. *Zakah* is a yearly obligation, aimed at raising the level of living of the poor (Qardawi, 1988). Allah (SWT) has sanctioned *zakat* with the intention of providing social security for the poor and needy in society, developing a balanced economic growth, and

becoming an act of spiritual purity and progress (Billah, 2016). It is not only an obligation and act of *ibadah* but also an institution for social development for Muslim societies. It can act like an in-house financial institution to abolish poverty from Muslim societies if not hundred percent still a good range and also it facilitates redistribution of wealth in the societies. It contributes to the development not only through financially but also through strengthening brotherhood of Muslims. *Zakat* can finance Small and Medium Enterprises (SMEs) which is better form of development than one-time spending of the poor and needy. In addition, this way jobs can be created, and unemployment problem can be reduced. *Zakat* money can be used for education and health issues by the deprived of Muslim societies.

In additions to *zakat*, there are many other different types of Islamic social finance institutions like *qard hasan*, *sadaqah*, *waqf*, etc. Among them *waqf* is important for socio-economic development of Muslim societies. If it is managed properly, *waqf* can have effective contribution in the development of the society through micro and macro levels. Through direct *waqf* schools, hospitals, etc. can be build. *Waqf* can be used to invest in commercial establishment and a community can be developed for lifetime. Resources of *waqf* can be used to build mosques, religious schools, institutions and spend on their maintenance. Well for drinking water, education, training, healthcare, care for animals, protection to the environment, and many other segments of the Muslim society can be covered by philanthropic *waqf*. As normally *waqf* is perpetual, it can develop an entire Muslim society. In that way *zakat* and *waqf* can be used together for government resource which will make it easier to alternate traditional taxation system.

D. Conclusion

Linking Islamic instrument like *zakat* with social responsibility and economic growth is an area which is often unspoken. As such, this research intends to find out the potential challenges *zakat* can face while it is used as fiscal policy tool which has link with Islamic socially responsible financing to economic growth to poverty alleviation mentioning few. Though many Muslim based countries using Tax as an alternative tool for government earning, *zakat* as a tool has broader spectrum from having impact on economic development to the role as an instrument for Islamic socially responsible finance. This research uses qualitative paradigm to analyze the literature. The research is based on a desk-based research with findings that there are challenges to establish *zakat* as prescribed in the revealed text which can be minimized through different actions. It is projected that properly executed plan to manage *zakat* could be used as an instrument of fiscal policy as well as an Islamic socially responsible financing instrument

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