Zakat versus Taxation as Islamic Fiscal Policy Tool

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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 a fiscal policy tool that has a 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 a broader spectrum from having an impact on economic development to the role as an instrument for Islamic socially responsible finance. This research uses a qualitative paradigm to analyze the literature. The research is based on desk-based research with findings that there are challenges to establishing zakat as prescribed in the revealed text, which can be minimized through different actions. It is projected that a 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 lives 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 the 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 the Islamic economy and zakat is one of those. The objective of this paper is to find out through qualitative analysis the challenges zakat faces as an Islamic fiscal policy tool compared to traditional tax as there should be sufficient reasons to mitigate them through possible ways.
B. Historical Background

In this part of the paper, the history of zakat is 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 zakat as an alternative to the 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. The 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-Fitr and zakat al-maal are the two types of zakat where zakat al-Fitr is paid at the end of the month of Ramadaan and zakat al-maal is the zakat on wealth. The purpose of Zakat al-Fitr 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 zakat is 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. Zakat is payable once in a lunar year and flexible on the person on the 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 zakat is paid at the time of harvest or extraction.

2. Before the Time of the Prophet (peace be upon him)

If we explore the history, zakat has a similar background to salah (prayer) as both had an existence before the establishment of Islam by the 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 divinely revealed restructuring. There is sufficient evidence from Qur’an which confirm its existence in the 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 Al-lah. 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)

3. 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 the 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 implementation in the society. While the ayats (verses) of the Qur'an revealed in Makkah were basically voluntary payments, after hijrah (migration to Madeenah), the revelation came in the 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 the case of zakat, it is the sunnah of the Prophet (peace be upon him) that gives us the details of the process, measure, items required to pay zakat on, 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 zakat able 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)
4. Post Prophetic Era

Different rates of zakat on different items observed and deduced from 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 includes zakat from livestock, zakat from gold, silver and jewellery, 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 has not occurred before this period (Hayeeharasah, Sehvises, & Ropha, 2013).

C. History of Tax

As per the research of Northeastern University, 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, that 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 the tax has blurry historical origin stating that the 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 were 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.

D. Zakat And Tax Comparative Differences

Mark Horton and Asmaa El-Ganainy (2020) from International Monetary Fund discusses fiscal policy and its impact statement 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 government expenditure and revenue. There
are three main positions in the government's deliberate fiscal policy: neutral, expansionary, and contractionary.

In short, neutral fiscal policy is generally embarked on when an economy is stable as government expenditure is covered by government revenue. There is a stable environment overall in the economy through the budget activities. Expansionary fiscal on work, while there is a 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 financial instruments of the 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 of 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 the system irrespective of the savings one has. (Abdullah et al., 2018).

The rate of zakat and minimum level of it is fixed by shari'iah which is not changeable by any government. On the other hand, as we know from the 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 a 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 fulfil our obligation but also act as a 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.
E. Discussion On Challenges Of Zakat

From a 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 the current time, it is hard to switch to zakat suddenly in countries where tax is exercised. It needs awareness from the government level to a personal level. Moreover, only awareness won't be sufficient. Following a proper transition, there will be a need for 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 the 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 travellers. 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 an exception for the 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 fulfill 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)

The 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, an 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 the right people in the 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 themselves.

F. Way Forward
We have seen in literature review section that zakat is rooted with the existence of human being on earth which was practised by people of other Prophets came before the last Prophet (peace be upon him), which indicates zakat is not a 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 the 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 the current world taking lesson and example from successful ones. From a transition perspective, Malaysia is an excellent example of bringing zakat with a 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 a 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 RinggitPlus (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 the transition from tax to zakat, which can be considered in places with a similar struggle.

Islam doesn't focus on material welfare. Rather it focuses on one submission to Allah and takes His prescribed way of life so that peace and tranquillity 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 the option to the population that they have to pay tax, and they can make zakat as well. Later they can be offered to choose between tax or zakat. In 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.

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. Therefore, there is a 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), kharaj (tax on agricultural land), etc. Waqf is a very important tool here which is emphasized by shari’ah having a broad area of research and implementation. Without support from other tools, transition to the zakat system won’t be easy or can assume won’t be possible. Proper training to administer, collect, distribute is needed to the 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 their own due and participate in their religious duty, which will serve as a socially responsible act as well. Transparency in management is also needed as there is a restriction of benefitting parties, which the zakat management authority needs to ensure.

G. Zakat As Tool For Economic Development

Qardawi (1988) mentions the goal of zakat as 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 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 as an in-house financial institution to abolish poverty from Muslim societies if not a hundred per cent still a good range, and also it facilitates redistribution of wealth in the societies. It contributes to the development not only financially but also through strengthening the brotherhood of Muslims. Zakat can finance Small and Medium Enterprises (SMEs), which is a better form of development than one-time spending of the poor and needy. In addition, this way jobs can be created, and the 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 the socio-economic development of Muslim societies. If it is managed properly, waqf can have an effective contribution to the development of society through micro and macro levels. Through direct waqf schools, hospitals, etc., can be built. Waqf can be used to invest in a commercial establishment, and a community can be developed for a 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.
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