ZAKAT AND SECULAR TAXATION

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ABSTRACT
This paper examines zakat, a major Islamic institution based on social justice, that makes it obligatory for a Muslim who satisfies certain conditions to contribute a portion of his wealth to society. Issues relating to zakat are discussed. The role of zakat and secular taxation in fulfilling societal needs are examined. A comparative study of zakat and secular taxation is made in which the underlying principles of zakat and the desirable attributes of secular taxation are analysed. Finally, the roles of zakat and secular taxation in fiscal policy are discussed in terms of their complementarity.

Keywords: Zakat, Taxation, Social justice, Fiscal Policy, Islam

INTRODUCTION

The institution of zakat¹, comprising of zakat fitrah and zakat on wealth, is enshrined in the five pillars of Islam. Zakat fitrah is obligatory only in the month of Ramadan whereas the obligation of zakat on wealth is not restricted to a specific time period. It is the latter, which will hereafter be referred to as zakat, that is the subject of this paper. In essence, zakat is a system of social justice that requires a Muslim to contribute to society a portion of his wealth if it is within his capacity/means to. Islam has provided a guideline to determine whether an individual is “able” and hence, obliged to pay zakat. There is a corresponding concept of nisab which is the minimum amount of wealth an individual needs to have before the obligation of zakat falls upon him. In addition, there is also the requirement for haul, i.e., the wealth must be in the individual's possession for one Islamic year (354 days) before he is obliged to pay zakat on it. Guidelines have also been provided by Islam on zakat utilisation. In particular, eight asnafs (or recipients) have been identified in the Quran as being eligible to receive zakat funds. Accordingly, zakat's importance in Islam is without question.

THE NEED FOR ZAKAT AND TAX

Tax is what the public authority in a country, e.g., the government, imposes as compulsory levy on members of society. Zakat, on the other hand, is an obligatory contribution Islam places on
the shoulders of those under its Faith. The fundamental justification for both zakat and taxation as socially acceptable or socially desirable institutions rests with the set of needs that they expect to satisfy. In particular, where subsistence needs are concerned, both taxation and zakat have similar objectives. Western philosophers have believed that the notion of fundamental justice means that people should not have to suffer simply because they lack the minimum amount of resources essential for living. It is therefore each individual’s entitlement, not a privilege, to be supplied with that minimum amount. The government, being the body politic that is accountable to society, naturally bears the major responsibility. Funds from taxation provide it with the means to discharge that responsibility.

The institution of zakat has its roots in the Islamic concept of social justice. This concept is best articulated in a hadith related by At-Tabarani on the authority of Ali, who was the son-in-law of the Prophet and the last of the four original Caliphs. In it, the Prophet had said that "Allah has enjoined upon rich Muslims a due to be taken from their properties corresponding to the needs of the poor among them. The poor will never suffer from starvation or lack of clothes unless the rich neglects their due; if they do so, Allah will surely hold them accountable and punish them severely".

Given the above arguments, one problem, however, in operationalising zakat and taxation is that of measuring the subsistence level or poverty line so as to ensure that resources needed to maintain an individual’s subsistence needs are not inequitably taxed or zakated away. The issue is obviously highly subjective and one that relies heavily on judgment. Indeed, not only does the poverty line differ between countries geographically, it also changes over time. In this regard, Islamic and Western thinkers have different interpretations.

Kiesling [1992] argues that it may in fact be possible to determine the poverty line objectively. One method, which he calls the culture-conscious general poverty approach, requires only that the poverty line or subsistence level as perceived by different sections of society be noted. If therefore, there are three groups in a society and each has its own idea about the subsistence level, one needs only to record those levels and determine the number of people in each group who fall below the respective levels.

Another may be by way of the minimum market basket approach. It involves looking at actual consumption patterns to see if they leave some minimum need unsatisfied. Experts such as doctors and nutritionists can help determine this. Presumably, some consensus can be reached as to what the minimum consumption bundle should be.

The Islamic approach as recommended by Shahar [1990] takes its cue from the nisab of zakat, the minimum amount of wealth that is necessary for the zakat obligation to fall on the wealth-owner. He believes that the nisab can be used to indicate the poverty line. Consequently, those above the line, having the obligation to pay, will not be eligible to receive zakat funds. Those falling under the line can then be assessed according to the Islamic standard of living prevailing at the time to determine their eligibility.

THE BENEFICIARIES OF ZAKAT AND TAX

Under contemporary taxation policies, there is no objective way in which tax revenues may be prescribed to be utilised. For the most part, the government has almost complete control over the management of the funds. The decision to utilise the funds will usually be made collectively between the executive and parliament, and in principle, be consistent with the overall objective of what they deem is a good fiscal policy.

In contrast, the entire administration of zakat is already defined in the Quran. There are guidelines governing the entire process of administering zakat from its collection to utilisation.
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Specifically, the Quran mentions eight categories of asnafs of zakat funds. They are: a) the fakir (the poor or indigent), b) the miskin (the needy), c) the amil (the zakat administrators), d) the muallaf (the new converts), e) the riqab (the slaves whose masters have promised them freedom if they pay up), f) the ibnu sabil (the wayfarers), g) fisabilillah (in the way of God), and h) the gharimin (the debtors).

It is obvious that the riqab, taken literally, are no longer in existence. Contemporary interpretation, however, views efforts to release people from the bondage of ignorance, oppression and even prostitution, as valid utilisation of funds allocated to riqab. As for fisabilillah, Muslim scholars differ as to its exact interpretation. Their views will be dealt with in more detail when we discuss fiscal policy. Generally, fisabilillah includes expenditures that further the cause of Islam. Perhaps the more complex issue, however, deals with the manner of distribution. While some Muslim leaders believe that zakat funds should be distributed equally, others hold the view that the distribution should be done based on needs; the asnaf with the most urgent needs being accorded the higher priority.

THE FOCUS OF ZAKAT AND TAX

It has been mentioned above that the primary function of taxation is one of fulfilling the subsistence needs. Promotion of community interests then, including the forging of social cohesion, is the fundamental drive behind public spending. Since the attention is focused on the larger social polity, and taxation itself is inherently secular, tax policies are unable to address the more micro issue of individual spiritual development. Hence in this setting, to the extent that taxation represents a mandatory transfer of wealth from individuals to a secular authority, there will be the motivation to avoid, if not evade, taxes. Zakat, on the other hand, has another dimension in that it is a religious obligation aimed not only at attaining social equity, but also at purifying the souls of those who fulfill their obligations:

"Of their good take alms,
That so thou mightest
Purify and sanctify them;
Verily thy prayers are a source
Of security for them:
And God is One
Who Heareth and Knoweth"

[at-Taubah:103]

There is thus a strive not only towards nurturing the spirit of sacrifice for larger societal concerns, but also towards the fulfillment of individual needs and satisfaction. In the long run, and with the proper inculcation of Islamic values, the zakat system of social justice has the potential to be self-regulating. This is rightly so because zakat appeals to the individual's conscience and therefore does not require the kind of regulations necessary for tax implementation.

THE UNDERLYING PRINCIPLES OF ZAKAT

While the requirement for zakat is clearly and firmly entrenched in Quranic injunctions, the principles underlying its important position in Islam may not be as straightforward. Shahar [1990] mentions six principles and these, we believe, are as applicable to zakat as they are to taxation.
The Principle of Justice and Equity

This principle can be witnessed both in the requirement for zakat itself and its implementation. The injunction for zakat stems from the pursuit of social equity through the redistribution of wealth. In the process, Islam dictates that its implementation be just to all parties. So items which are purely meant for private consumption (such as gold jewellery) are exempted from zakat. Additionally, different rates apply to different kinds of wealth. For example, the rate is 10% for agricultural produce but only 5% if irrigated through human effort. The underlying principle then is to recognise adequately the efforts expended to produce the wealth.

The Principle of Balancing Maslakah (Public Interest) and Individual Interest

This principle is intimately linked to the first one in that zakat aims to balance the interest of the public with individual concerns. The issue of zakatable livestocks is an example. It is required that those kept for special purposes such as breeding, or those that are either too young, too old or deformed, are not to be given away as payments for zakat.

The Principle of Avoiding Hardships

Islam’s inclusion of zakat as a religious obligation is not intended to impose undue hardship on Muslims. This principle can be attributed to two Qur’anic injunctions:  

i) “There is no hardship in religion” [al-Hajj:18]; and  
ii) “God takes not a soul beyond its capacity” [al-Baqarah:286]

Accordingly, amounts attributable to irrecoverable debts, for example, are exempted from zakat.

The Principle of Certainty

This pertains to the certainty in the manner zakat funds are to be utilised. Implicit in this principle is the notion that zakat is not an end in itself, but rather, is a means to a noble end.

The Principle of Wealth-Sharing

One of the immediate consequences of zakat is the preclusion of wealth concentration in a select group of social elites. The benefits, however, extend not only to zakat beneficiaries but also to those who possess wealth through greater social cohesion and stability.

The Principle of Growth

The aim of zakat is not to discourage the accumulation of wealth. On the contrary, it is meant to provide the impetus for people to work harder so as to maintain, if not increase, their level of wealth. It is with this in mind that an orphan’s wealth held in trust is required to be invested so as to prevent its depletion through zakat payments.

While the principles discussed above are intrinsic to zakat and its implementation, they do not naturally pervade in the nature of secular tax and its implementation. Whether they provide the
guidance for a tax policy depend ultimately on the values, beliefs and political system of the governing body that imposes and administers it. It is also subject to the government's use of other fiscal tools. It is, however, clear that both zakat and taxation share the same basic premise of fundamental or social justice. To attain social justice and equity, and to avoid undue hardships, many governments apply progressive tax rates while simultaneously institutionalising other measures like rebates and subsidies. To protect individual interests while promoting the public cause and wealth-sharing, tax policies would have to possess the flexibility to address unique circumstances. They also have to be consistent with public spending that provides benefits to the masses such as public housing for the lower income groups. To encourage growth, entrepreneurship and individual effort, progressive tax rates should neither be prohibitively high, nor should the tax range be too wide. The above six principles have universal relevance and may provide some basis for a tax-based policy.

THE DESIRABLE ATTRIBUTES OF SECULAR TAXATION

Having discussed the principles underlying zakat and their relevance to taxation, we examine the attributes that make a "good" tax system and consider whether zakat, though essentially not a tax, have similar attributes. Stiglitz [1988] outlines five attributes: a) economic efficiency, b) administrative simplicity, c) flexibility, d) political responsibility, and e) fairness.

Economic Efficiency

Economic efficiency means that the "tax system should not interfere with the efficient allocation of resources". A good example of economic distortion caused by an inefficient tax system is the excessive drilling caused by the special treatment of oil and gas in the United States. To be non-distortionary therefore, the tax must generate no extreme behavioural reaction by individuals or interest groups as a result of economic consequences.

Zakat, with its emphasis on developing the individual spiritually, is non-distortionary. In the absence of any formal regulation in a zakat-based system, the individual has the freedom to do as he pleases; he is primarily guided by his own conscience and faith in the religion. Furthermore since zakat has proportional rates which are fixed and relatively low, it cannot conceivably penalise productivity or savings.

Administrative Simplicity

This refers to the amount of effort needed to implement the tax system. The more complex the system is, the more administrative work will be required and therefore, the higher the costs. Three factors determine the costs of tax implementation. First, the amount of records that will have to be kept by the taxpayer regardless of whether there is taxation or not. This is the cost the tax system imposes on the individual taxpayers. Second, the complexity of the system. Third, the degree of differentiation of the rates across individuals (with some individuals paying a much higher rate than others) and across categories of income which may result in some "shifting" of income from the higher income-earner in the family to a lower-income member.

The costs of running a zakat-based system can thus be measured against the above factors. The costs the system imposes on companies and organisations will be minimal since they are already required to maintain full records. Private individuals will be affected to a larger extent, but even the costs involved are insignificant since they only have to maintain simple records pertaining to salaries and other forms of income. Moreover, zakat is essentially a simple religious obligation
and hence, does not incur the costs that a more complex system will. Lastly, since zakat rates are proportional, they do not make income "shifting" feasible.

Flexibility

A tax system is said to be flexible if it is able to react to changing economic circumstances accordingly. For example, whether the system is able to decrease revenues during a recession, or vice versa, would be a measure of flexibility.

In this regard, zakat may not exhibit the same kind of flexibility that a progressive tax system has because of its fixed rates and base (see Appendix). However, it is important to realise that the importance of this attribute lies in its ability to stabilise the economy. We discuss fiscal policy below wherein zakat can have a significant stabilising effect on the economy.

Political Responsibility

It is the government's responsibility that the tax system should be designed so that individuals can ascertain what exactly they are paying for. In short, the system should be transparent enough to show to the public the manner in which the government utilises the funds.

Zakat, by virtue of its religious nature, can never be used as a political tool. This is because the distribution of zakat is institutionalised in the eight asnafs. One can therefore see no problem for an Islamic State to disclose its expenditures because Islam requires the zakat-administrators to be responsible and accountable.

Fairness

This attribute requires the tax system to be fair in its relative treatment of different individuals. The concept of fairness consists of horizontal equity and vertical equity. There is horizontal equity if individuals who are the same in all relevant respects are treated equally; and vertical equity if individuals who are able to pay higher taxes are required to do so.

Zakat is horizontally equitable in the sense that it does not differ in its treatment of individuals. Vertical equity in zakat can best be seen not in terms of marginal utility but in terms of the relative amounts collected from the individuals. The more able the individual is, the more amount of zakat he will have to pay.

THE ROLE OF ZAKAT AND TAXATION IN FISCAL POLICY

Since tax usually constitutes the largest component of government revenues, it plays an important function in the fiscal policy of the economy. It is in this context that a comparison of tax and zakat would be particularly insightful; not least because zakat may be espoused as the basis for fiscal policy in an Islamic economic system.

The Failure of the Market

The market, because it operates on the basis of profits and private gains, will invariably fail for public goods. In the event that government intervention is required to rectify the failure, an effective tool and/or funds will be required. Taxation, in many cases, provide the government with that tool and funds [Musgrave and Musgrave, 1989]. For example, when the market fails to produce public goods, the government must assume the role of producer and provide those goods. Expenditures such as those on the police and defence forces cannot be reasonably charged to individual users. Their consumption too cannot be restricted to those who pay for them. Under
such circumstances, funds from taxes are used to provide these goods. Whenever necessary, taxes can be imposed and the rates varied.

Similarly, zakat funds can be used to provide these goods. Such expenditures, in practice, have been classified under fisabillah. Specifically, Muslim leaders have identified those public goods which ought to be provided by an Islamic State and hence, the extent to which the zakat funds can be utilised under fisabillah. Taymiyyah, a Muslim economist, lists national defence, internal security, roads and bridges, canals and waterways, as well as education as those expenditures which can be financed by zakat funds [Shahar, 1990].

Other Muslim thinkers like Hazm and Imam Nawawi include food, drink, clothing and decent housing as items that the state ought to provide [Shahar, 1990]. It is interesting to note that in this regard, zakat, if fully utilised, has a built-in mechanism to ensure the production of public goods. This is because when part of the income of the rich is transferred to the poor, a part of the production and consumption of non-essential goods and services is similarly transferred to produce and consume the essential ones.

The Distribution Function

The redistribution of income plays a pivotal role in maintaining justice and equity. For taxation, the distribution function can be effected in three ways. First, through a tax-transfer scheme, the government can combine progressive tax with subsidies to the low-income group. Second, a scheme can be designed that combines taxes on goods purchased mainly by the high-income group (such as luxury goods) with subsidies for goods purchased by the low-income group. Third, funds from a progressive tax system can be used to finance public goods and services [Musgrave and Musgrave, 1989]. The first two policies are largely indirect distributions whilst the last one serves a more direct distribution function.

For a zakat-based policy, the distribution function is not undertaken indirectly and thus has a more direct effect. How the distribution function itself is carried out however, is a source of some disagreement amongst Muslim scholars [Shahar, 1990]. The Hanafis and Malikis (two of the four Islamic school of thoughts) believe that zakat funds must be used in a way that results in the transfer of ownership. This is based on their interpretation of a Quranic injunction specifying the zakat beneficiaries. They thus reject the use of zakat funds for "impersonal purposes such as building mosques, bridges and the like". Consequently, zakat, they believe, can be used on "persons" such as the needy. In this regard, education and health programs are generally accepted as legitimate utilisation of zakat funds. Contrary to this stand, other Muslim scholars believe that while the other seven asnas are very specific, the funds allocated to fisabillah can be utilised more flexibly and innovatively. Accordingly, they believe that zakat funds can be spent on such public expenditures as aiding madrasahs and mosques.

The Stabilisation Function

The government counts among its numerous responsibilities the duty to stabilise the economy and prices while at the same time maintaining high employment. One oft-used tool in achieving these twin objectives is taxation. By imposing or removing taxes and/or by adjusting the tax rates, the government can actually influence the level as well as the types of activities [Musgrave and Musgrave, 1989]. The effectiveness of this tax-based policy however, is limited to some extent by three types of time lags. The first is recognition lag which is the lag between the time when the need arises and when this need is recognised by the government. The second is implementation lag which refers to the lag between the time when the decision is made to take
action and when it is eventually implemented. The third refers to response lag, the lag between the time when the action is implemented and when it becomes effective. As a result of these lags therefore, the intended effects are often delayed. Indeed, it may even be destabilising if, by the time the policy takes actual effect, conditions have changed to render the original policy inappropriate. It has also been argued that because the government has huge discretionary powers in a tax-based policy, political considerations (such as an impending election) may be the overriding motive instead of long-term economic stability.

Zakat too can be used as a stabilising tool [Shahar, 1990]. In particular, zakat has the potential to stabilise economic conditions in times of inflation and recession. It has been mentioned before that zakat is a charge on wealth, income and savings. As such, it can help reduce excessive consumption in inflationary times. When the economy slows down, zakat, with its fixed rates and broad base, acts as a built-in stabiliser by cushioning the impact of falling income. There are two other ways in which zakat can help revive the economy. First, since zakat funds are channeled back into the system, economic activities can be stimulated. For instance, the funds allocated to the poor and needy can increase the consumption on essential items. Second, zakat serves to promote investments because it "penalises idle assets".

TAXATION IN ISLAM

It may be argued that since zakat has a fixed base and rates, it may prove inadequate when taxes and expenditures need to be raised. Accordingly, the imposition of taxes may serve as a complementary measure to the zakat-based system. There is, however, no consensus on the matter. Some argue that though taxes may be necessary, they stress the need for the taxes to be just and their imposition, an exception rather than the norm [Shahar, 1990]. For those who disagree, the issue is not merely the justness of taxes, but more fundamentally, whether it is permissible in Islam. Their reservations are based on their interpretation of the Quran, one of which says that a Muslim should not take the property of another Muslim without his consent. Taxes, it is argued, should be limited to the Sunnah and Quranic injunctions. There are, specifically, two types of taxes mentioned in the Quran: the jizya and khums. Jizya is levied on non-Muslims by the Islamic State in return for military defence and protection. The agreement may be set by a treaty and the amount, reimbursable in the event the State fails to fulfill its obligations. Khums is a tax levied on the spoils of war. The amount to be paid is one-fifth of the total value of the spoils. From the above arguments it does appear that taxation may have a limited scope in Islam.

CONCLUSION

Zakat is enshrined in the five pillars of Islam. It plays a very significant role, as a major Islamic institution, in ensuring social justice and equity, and of caring for the socially less fortunate. A comparative analysis between zakat and secular taxation yields some interesting insights. Secular taxation may learn from the principles of zakat in formulating and implementing a set of taxation policies as an instrument of fiscal policy. For example, contemporary taxation policies do not objectively prescribe how tax revenues ought to be allocated; it can perhaps derive from the zakat principles on the asnafs as a basis for meeting societal needs. Zakat generally satisfies the desirable attributes of a secular taxation system. With its emphasis on individual spirituality, it contributes to economic efficiency, it can be administratively simple, is certainly apolitical and fair. Zakat also complements secular taxation in the market for public goods, and in its stabilisation and distribution roles in the economy.
GLOSSARY

Amil
Zakat administrator

Asnafs
The eight recipients of zakat as stated in the Quran

Baitulmal
Funds derived other than from zakat and fitrah

Caliphs
The Four Muslim leaders after Prophet Muhammad

Darul Arqam
Muslim Converts' Association Of Singapore

Fakir
The poor and indigent

Fatwa
Religious decree

Fisabilillah
The way of God

Fitrah
Obligatory payment paid in the month of Ramadan

Haul
One Islamic calendar year (354.5 days)

Ibnisabil
The wayfarers

Jamiyah
Muslim Missionary Society of Singapore

Madrasah
Islamic religious school

Miskin
The needy

Muallaf
New converts to Islam

Nisab
Minimum amount of wealth that an individual needs before the
obligation of zakat arises

Riqab
Slaves

Sunnah & Hadiths
The words and deeds of the Prophet Muhammad

Syariah
Islamic law as prescribed in the Quran and Sunnah

Ustaz
Religious teacher/scholar

Zakat
Obligatory payment based on wealth

APPENDIX: WHAT IS ZAKATABLE AND ITS COMPUTATION

The Islamic Religious Council of Singapore (MUIS) has ruled that the following are zakatable based on its opinion and interpretation of the Quran and sunnah:

- Savings
- Equity Investments
- Gold
- Business Assets
- Central Provident Fund (CPF)² savings

An obligation to zakat the above assets arises if all the following four general conditions are met:

1. The person who owns the asset is a Muslim.
2. The asset must be fully owned and free from any encumbrances and charges as prescribed in the sunnah.
3. As prescribed in the sunnah, the asset must be in the owner's possession for a period of one Muslim calendar year (354.5 days). This requirement is cited as haul.
4. In addition to satisfying the haul, the sunnah states that the value of the asset must be equal to or greater than the value of 86 grammes of gold throughout the haul period. This condition is termed as nisab.

There are probably other possible bases of zakat that MUIS has been silent on. In Malaysia, for example, income and salary are ruled to be zakatable by its religious authorities which also based its interpretation on the Quran and sunnah [MAIWP Guide Book, 1995]. The issue on the constituents of zakat are therefore very much dependent on the views of religious authorities such
as MUIS. Whereas the bases can vary from country to country, the sunnah explicitly states that the rate of zakat is 2.5%. Even though the rate is fixed at 2.5%, the method of calculation varies as there are no prescribed method mentioned in the Quran and sunnah. Therefore the decision as to what method to adopt is left to the discretion of the religious authorities such as MUIS. As to the question of nisab, it is prescribed in the sunnah that its value is pegged to the market value of 86 grammes of pure gold.

Therefore it can be concluded that the zakat laws and their applications are a mixture of shariah law, as embodied in the Quran and sunnah, and also religious decree from the highest religious authority.

MUIS [1995] provide guidelines on the computation of zakat on savings, shares, gold, business assets, and CPF savings. Presented below is an explanation of the computation of zakat on savings. For the purpose of the analysis, the nisab is valued at $1500 and the haul is taken to be 365 days in the illustration shown. In addition, the first two conditions, i.e., being a Muslim, and having full ownership of the asset, are also assumed to be satisfied.

**ZAKAT ON SAVINGS**

Savings refers to cash in hand or deposits with financial institutions. However, deposits are only zakated on the principal value and elements of usury (interest) are disregarded in the calculation.

Currently there are three alternative methods of calculation prescribed by MUIS:

1. 2.5% is levied on the minimum balance registered during the haul period
2. 2.5% is levied on the minimum balance of every month in the haul period
3. 2.5% is levied on the balance registered at the end of the haul period

**An example of zakat calculation on savings**

Method 1 is used as an illustration. The figure below depicts the movement in the balances of a savings account.

1. Assume that the Nisab level is at $1500

![Balances of Savings](image)

2. As the balance had exceeded the nisab for the first time in July 1998, the haul period commences from July 1998.
3. For the next 12 months, the balance never fell below the nisab level and therefore on July 1998, i.e at the end of the haul period the liability to zakat crystallises.
4. Under method 1, the minimum balance registered during the haul is the sum zakated.
5. Zakat calculations are as follows:
   Zakatable sum = $1700
   Zakat liability = $1700 x 2.5%
   = $42.50

Endnotes

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1. A glossary that explains such Islamic terms is found at the end of the paper.
2. This is a mandatory pension fund set up by the Government of Singapore in which both the employer and employee make monthly contributions based upon prescribed percentages of the employer wages and salaries.

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