Informal taxation systems – Zakat and Ushr in Pakistan as example for the relevance of parallel/semi-public dues

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Informal taxation systems – Zakat and Ushr in Pakistan as example for the relevance of parallel/semi-public dues

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Abstract

This article provides an overview of the religious background of Zakat and the organisation of the Zakat collection in several Islamic countries. Then the mandatory system in Pakistan of Zakat and Ushr is described in more detail. Zakat and Ushr are spent mainly on much targeted areas like social welfare, education and health care for certain population groups. Other types of public goods and services are not covered with funds received from Zakat. Hence, the question arises, whether an Islamic state is according to the Islamic laws entitled to collect additional revenues like taxes in addition to Zakat.

A second question is answered in the text, in how far an engagement of religious leaders in tax reform activities is in line with the Islamic law and can contribute to development activities. Taking into account the cultural and religious factors and actors, the involvement of Mullahs or Friday prayers to promote tax morale requires the support of religious scholars, but might have broader impacts even than governmental activities on the public awareness. To answer both questions it is important that - according to important religious scholars - the Islamic state requires additional revenues to cover all necessary demands of its population. One permitted option to collect additional revenues is taxation.

Finally the different types of individual giving increase the total amount paid to formal and informal taxation systems in Pakistan by about 1%. Nevertheless, formally the tax to GDP ratio does not change, because Zakat is statistically classified as social assistance benefits, which do not become part of the tax to GDP indicator.

Keywords: Informal taxation system, Islamic taxation, Zakat, Ushr, tax to GDP ratio, Pakistan

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1. **Zakat as third pillar of Islam**

The five pillars of Islam are basic acts, which are considered obligatory by believers and are the foundation of Muslim life. The Quran presents them as a framework for worship and a sign of commitment to the faith. They are:

1. Islamic creed (shahada)
2. daily prayers (salah)
3. almsgiving (zakāt)
4. fasting during the month of Ramadan (sawm)
5. pilgrimage to Mecca (hajj) at least once in a lifetime.

Zakāt means to purify and translates that by giving up a portion of one’s wealth, one purifies the portion which remains, and also oneself, to a restraint on one’s greed and imperviousness to others’ sufferings. The Qur’ān talks about the zakat in more than 30 different verses. In the Qur’ānic view, zakat is a way to redistribute the wealth, thus increasing the flow of cash in the economy with a particular interest in the poor and the dispossessed Muslims. However, zakat is considered more than taxation - one must give zakat for the sake of one’s salvation. Neglecting to give zakat can result in damnation in the afterlife, while those who give zakat can expect reward from God in the afterlife. The giving of the zakat is considered a means of purifying one’s wealth and one’s soul.

Zakat is expected to be paid by all practicing Muslims who have the financial means (nisab). In addition to their zakat obligations, Muslims are encouraged to make voluntary contributions. The zakat is not collected from non-Muslims, although they are sometimes required to pay the jizyah tax.

The amount of Zakat to be paid by an individual depends on the amount of wealth, and the type of assets the individual possesses. The Quran does not provide specific guidelines on which types of wealth are taxable under the zakat, nor does it specify percentages to be given. The amount of zakat to be paid on capital assets (e.g. money) is 2.5% (1/40). Zakat is additionally payable on agricultural goods, precious metals, minerals, and livestock at a rate varying between 2.5 (1/40) and 20%, depending on the type of goods.

Zakat is also one of the ten practices that Shia Muslims must perform, called the Ancillaries of the Faith. The rules are similar to Sunni Islam, but here Zakat only applies to cattle, silver, gold,

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dates, raisins, wheat, and barley. Zakat is separate from the practice for Shi'i'ites, which are additionally expected to pay one fifth of their income.

Zakat is only payable on assets continuously owned over one lunar year that are in excess of the nisab, a minimum monetary value. The nisab is calculated after adding the cash value of zakatable assets (gold, silver, cash, stocks, merchandise for business, livestock etc.). Personal assets such as clothing, household furniture, one residence etc. are not considered zakatable assets. The nisab for gold and other money is the value of 85 grams of gold at world prices. Thus, at 2012 prices, the nisab for such assets was about 5,200 USD.

Today, in most Muslim countries, zakat is collected through a decentralized and voluntary system, where eligible Muslims are expected to pay the zakat based on worship and love of God. Under this voluntary system, zakat committees are established, which are tasked with the collection and distribution of zakat funds. In a few Muslim countries – including Pakistan – the zakat is obligatory, and is collected in a centralized manner by the state. In others the zakat is regulated by the state, but contributions are voluntary. The following table provides a country overview:

Zakat systems – country overview:

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<th>No government system</th>
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<td>Uzbekistan</td>
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According to the Quran there are eight categories of people who qualify to receive zakat funds:

1. Those living in absolute poverty

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2. Those who were restrained because they cannot meet their basic needs
3. The zakat collectors themselves
4. Non-Muslims who are sympathetic to Islam or wish to revert to Islam
5. People whom one is attempting to free from slavery or bondage. Also includes paying ransom or blood money
6. Those who have incurred overwhelming debts while attempting to satisfy their basic needs
7. Those working in God’s way
8. Children of the street / Travellers

Additionally, the zakat funds may be spent on the administration of a centralized zakat collection system. Zakat should not be given to one’s own parents, grandparents, children, grandchildren, or spouses. It is also forbidden to disburse zakat funds into investments instead of being directly given to those who are in need.

2. Zakat and Ushr in Pakistan

There is also consensus among scholars nowadays that even if people pay other taxes, the obligation of payment of Zakat does not lapse. Zakat has been made compulsory for Muslim citizen in Pakistan through the promulgation of the Zakat and Ushr Ordinance No. XVIII in 1980; even though citizens pay other taxes such as income tax, sales tax, and import tax. However, Zakat paid can be deducted from total income liable to income taxation. Even though only a minority of 15% explains that Zakat payments are used for tax-saving reasons.5

The ordinance makes the collection of Zakat compulsory at source from eleven different asset types. The ministry of religious affairs, Zakat & Ushr (MORA) administers the collection of Zakat and maintenance of relevant accounts. The amount of Zakat so deducted is credited in Central Account No. 08-Central Zakat Fund, maintained with the State Bank of Pakistan.6

The disbursement of Zakat takes place by transfer of funds to the Provincial Zakat Council which in turn transfer it to District Zakat Committees (DZCs). The actual disbursement is made at local level through Local Zakat Committees (LZCs) and other institutions.7 MORA allocates funds to the province according to the percentage of population of each province for its disbursement according to the law and the provisions of Zakat Disbursement Procedure approved by the Central Zakat Council (CZC).8 There are 35 DZCs and approximately 25,267

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8 See MORA, which mainly deals with pilgrimage, http://www.mora.gov.pk/.
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LZCs engaged in disbursing Zakat money among beneficiaries; and it is difficult to deduct fraudulent practices.9

In the early development of the Islamic community, Zakat was collected as a tax by the state, and the funds were distributed to defined needy groups.10 Usually provincial Zakat & Ushr Departments support the distribution of Zakat under different programmes, like special allowances for destitutes, widows and old aged persons (Guzara), educational stipends to students from primary to university level of educational institutions and religious education in Deeni Madaris, health care like free treatment of poor patients through a hospital, rehabilitation, marriages of poor girls (Jahez) and stipends to poor students (Musthiq) of technical institutions.11

The individual giving includes the obligatory (by religion not by tax law) festival charity (Zakat-ul-fitr often given in kind) and charitable wealth tax (Zakat-ul-mal). The zakat deducted at source by the government only includes the Zakat-ul-mal, which is legally not obligatory and can be substituted by the option of paying zakat privately on their own. A judgment of the Supreme Court, however, has allowed all sects to file a declaration seeking exemption from payment of Zakat on financial assets. This puts in jeopardy the mechanism of compulsory deduction and thus, the level of contributions (also compare with section 3).12

The amount of privately distributed Zakat not channelled through any government institution was estimated with about 14 billion PKR in 1998, which is three times higher than the officially collected amount of about 4b13.14 The governmental Zakat figures increased slightly in the following years from 4.3b in 2000 to 4.6b PKR in 2005.15 More than 50% are deductions from bank accounts.

Individual giving by type:

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15 See SBP, Zakat.
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Adding up all financial and in kind Zakat donation types (but excluding volunteering, since time use is not included in other countries figures and does not allow for international comparison as well as non-Zakat money) leads to a total of 25b PKR individual Zakat plus 4b for governmental Zakat giving for 1998.\(^{16}\) Tax revenues collected in 1998-99 were 391b PKR and tax to GDP ratio for 1998-99 is given with 13.3%.\(^{17}\)

Including individual Zakat giving into the payments of informal taxation systems leads to an adjusted tax to GDP ratio of 14.3%; payments to formal (391b) and informal (29b\(^{18}\)) taxation systems are increased by 7%. These figures are only a first rough estimation and need further refinement due to statistical definitions and detailed distribution channels of Zakat.

3. Statistical classification of Zakat for tax to GDP calculation

This section answers the question which types of Zakat count for the calculation of the tax to GDP ratio. According to Eurostat publications the total tax to GDP ratio consists of indirect taxes, direct taxes and social contributions. The latter are further subclassified as social contributions by employers, employees and self and nonemployed.\(^{19}\)

In more detail, the commonly applied indicator for total taxes defines them as taxes on production and imports (D.2), current taxes on income and wealth (D.5), capital taxes (D.91),

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\(^{16}\) Philanthropy in Pakistan, 11. An alternative data source is HIES 2007/8 und 2008/9, which cover zakat expenditures (code 829) and disaggregate in zakat expenditure to public sector (830) and to private sector (831).


\(^{18}\) Informal taxation system here contains officially collected governmental Zakat, Zakat money and gifts in kind, which are typically given as Zakat-ul-fitr.

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actual compulsory social contributions (D.61111 + D.61121 + D.61131).\(^{20}\) Indirect taxes, direct taxes and social contributions add up to the total of taxes received by the general government. Taxes (excl. SSC) are defined as total taxes (incl. SSC) minus actual compulsory social contributions.\(^{21}\) Payments of actual social contributions may be compulsory by virtue of a statute or regulation, collective agreement in a particular industry, agreements between an employer and employees in a particular enterprise, included in a contract of employment or, in certain cases, contributions on a voluntary basis. To distinguish between social contributions which are compulsory and those which are voluntary, a supplementary level is included in the classification with D.6XXX1 for compulsory and D.6XXX2 for voluntary.\(^{22}\)

World Bank defines tax revenue as compulsory transfers to the central government for public purposes. Certain compulsory transfers such as fines, penalties, and most social security contributions are excluded.\(^{23}\) According to this definition the tax to GDP ratio (with only the federal tax revenues) would decrease to 14.6%. Following this definition the majority of financial Zakat contributions cannot be counted as contributing to the tax to GDP ratio, since only a small share of 7.1% is channelled through governmental organisations; the rest is given directly to individuals.

Finally, the SNA 2008 clearly distinguishes between social contributions and social transfers. Social contributions are payments to social insurance schemes to make provision for social insurance benefits to be paid, which is not the case for any type of Zakat (financial, in kind, to organisations nor to individuals). According to this definition Zakat (whether cash or in kind) falls under social assistance benefits, which are current transfers received by households intended to provide for the needs that arise from certain events or circumstances like sickness, unemployment, retirement etc. This category is not part of the tax to GDP calculation.\(^{24}\)

4. Complementary relation of Zakat and taxes

Zakat and taxes have certain similarities. 1) In countries where Zakat is compulsory it is liable to be collected by force like tax, if the payer does not pay it willingly. 2) Zakat, like tax, is paid though there is no direct and equivalent economic benefit obtained by the payer; indirect the Zakat payer may expect return in the life hereafter and the tax payer may receive some public service from the state in return, but there is no direct correlation.

\(^{24}\) Definition of tax to GDP ratio http://diepresse.com/home/wirtschaft/economist/168819/print.do
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There are also important conceptual and other differences between Zakat and tax: 1) Zakat is permanent, cannot easily be eliminated by a governmental or legislative action. 2) Zakat has fixed rates, exemptions and zakatable items cannot be altered. 3) Zakat has specific recipients and cannot (unlike taxes) be used for other government objectives. 4) Zakat is enhanced by religious zeal as a part of religion. If it is collected by the government it must be collected in its name and designated for its recipients as an autonomous duty and operation.

The following arguments demonstrate why Islamic states require the imposition of taxes in addition to Zakat and in which areas taxes even strengthen the Islamic state.²⁵ Al-Qardawi (1999) as important religious scholar also mentions that evidence against taxes beyond Zakat from the Hadith is either weak or not unequivocal, whereas the evidence in support of dues other than Zakat from the Quran and Sunnah are very strong.

1) Islamic jurists widely agreed upon the genuine need for Muslim states that tax can be imposed even after Zakat.²⁶

2) Certain public goods and services are not provided by Zakat resources i.e. running of general administration, infrastructure, security etc. This requires the imposition of taxes beyond Zakat.

3) The general principle holds that ‘avoidance of damage will get priority over doing of good’. If proper economic duties are not performed by the state due to lack of resources, this will lead to serious public dissatisfaction and create violent situation. As such, the state has to obtain required amounts of resources through taxes for carrying out its duties.

4) Allah has made it obligatory to carry out Jihad (defence of Islam and Islamic territory and to put an end to oppression anywhere in this world) through employing one's life and wealth. This is a duty beyond Zakat. To carry out a major Jihad in this age, if needed, there is no other way but to raise resources through taxes.

Therefore, Zakat alone cannot meet the need of general revenue and also the Islamic state requires additional sources for funding public goods and services. Some scholars even argue that a policy of levying zakat would even work against the poor, when what is needed is a


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comprehensive and socially progressive tax policy, which is hampered or even neglected in the sake of Zakat only. 27

5. Involvement of religious leaders in tax reforms

Taking into account the cultural and religious factors and actors, the last point is important for potential support of religious leaders to strengthen revenue collection or tax reforms. The involvement of Mullahs or Friday prayers to promote tax morale requires the support of religious scholars. For this question it is important whether taxes are perceived at least as acceptable or even supportworthy by religious leaders.

There are several examples for cooperation of development organisations with religious authorities, which are quite successful especially in awareness building measures. 28 Development organisations cooperated for example closely together with Imams and Quran teachers in Algeria on the topics biodiversity and protection of natural resources. Here firstly interlinkages between research and religion were built and secondly orientations for Friday prayers have been developed. Furthermore biodiversity courses became part of the curriculum in Quran schools, which included the development of training material as well as teacher training on the subject. 29 Another example is Yemen, where religious arguments and authorities have been consulted to increase the acceptance of water fees from the consumers.

For other areas there are also examples from Pakistan, since in 2007 some of the conservative religious clerics in two Pakistani provinces claimed that the polio vaccine is an ‘Infidel Vaccine’ and the main purpose is to sterilize Muslims and blamed it to be a western plot against Muslims. Some of the religious clerics even claimed that it is un-Islamic to vaccinate their children and those who die of Polio are martyrs. Unfortunately, due to lack of information and awareness of the local people, 24,000 children were deprived of polio vaccination just because of this controversy and it became difficult to run polio awareness campaigns in these areas. The awareness campaign was halted after health professionals were even targeted during a polio awareness campaign. After that the international health community has involved prominent religious clerics signing a fatwa (a religious order) endorsing vaccinations. Health workers in the province were given copies of this fatwa to convince people to get their children vaccinated. 30

29 See http://www.giz.de/Themen/de/35433.htm.
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Generally religious institutions often have a broader scope for awareness building than governmental structures or NGOs, which might be applied for broadening of governance topics.

6. Conclusion

In conclusion we were able to show that Zakat plays an important role in many Islamic oriented countries with mandatory and voluntary government systems, but also for those without formal governmental Zakat system. Zakat and Ushr in Pakistan is mainly spend on very targeted areas of support like social welfare, education and health care for certain population groups. Other types of public goods and services are not covered with funds received from Zakat. Therefore, according to important religious scholars the Islamic state requires additional revenues to cover all necessary demands of its population. One option to collect additional revenues is taxation. Finally the different types of individual giving increase the total amount paid to formal and informal taxation systems in Pakistan by about 1%, which is an increase of 12% of the current tax to GDP ratio of 8.6%. Nevertheless the official tax to GDP ratio does not change, because Zakat is statistically classified as social assistance benefits, which do not become part of the tax to GDP indicator. Even if Zakat payments as informal taxation system do not formally increase the tax to GDP ratio, the (informal) tax burden for taxpayers does exist.