

DEVELOPING A FRAMEWORK OF INDIRECT TAXATION SYSTEM FROM SYARIAH PERSPECTIVES

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Abstract: *The aim of this paper is to provide a conceptual framework of indirect taxation system from Shariah perspectives. The framework is developed based on the thought by 3 well-known Islamic Scholars in the field of Public Finance particularly in indirect taxation system which are Abu Yusuf Yaqub bin Ibrahim, Al-Qardawi and Chapra. This study employed qualitative methodology which is content analysis from secondary source based on data collected from rules, law as well as in-depth interview with Deputy Finance Minister, Malaysian National Fatwa Committee, Deputy Secretary General of Treasury (Policy), Director General of Royal Malaysian Customs Department and Tax Division Section Head (Indirect Tax) Ministry of Finance and pre-determined officers from Royal Malaysian Customs Department. This article explores the model and wisdom of indirect tax practices as being discussed and outlined by past Islamic leaders in fulfilling their obligations towards managing the nation as well as protecting people's wellbeing. The framework is to provide a comprehensive and practical guidance to the policy maker in formulating Shariah-based indirect taxation policies in Malaysia. Good governance in the implementation of indirect tax policy is important to ensure the well-being of Malaysian and Ummah. Its significance to an academic field where lack of empirical study conducted to ascertain the syariah compliance of the current practices in Malaysian indirect taxation. Furthermore, the public in general will indirectly benefit from this study as the tax authority is functioning based on Syariah principles.*

Keywords: *Indirect Taxation System, Conceptual Framework, Islamic Economics, Content Analysis, Good Governance*

INTRODUCTION

In Malaysian context, as shown in Table 1.1, tax contributed an average of 83.63% or RM145.017 billion from the overall National income for a period of 2007-2016 (Direct tax: RM107.257 billion or 61.86% while indirect tax: RM37.76 billion or 21.77%). Tax revenues consists of Direct Tax under purview of Inland Revenue Board Malaysia (IRB) and Indirect Tax under authority of Royal Malaysian Customs Department (RMCD).

Table 1.1: Malaysian Tax Revenue and Government Revenue 2007 – 2016

YEAR	IRB (RM in Billion)	RMCD (RM in Billion)	TOTAL (RM in Billion)	GOVT. TOTAL (RM in Billion)	%
2016	114.00	76.197	190.197	212.42	89.54%
2015	121.186	61.950	183.136	219.10	83.59%
2014	133.70	35.196	168.896	220.60	76.56%
2013	128.933	33.126	162.059	213.37	75.95%
2012	124.892	32.319	157.211	207.91	75.61%
2011	109.609	30.388	139.997	161.40	86.74%
2010	86.50	28.15	114.65	127.20	90.13%
2009	88.40	25.90	114.30	132.90	86.00%
2008	90.65	28.60	119.25	128.40	92.87%
2007	74.703	25.772	100.475	110.70	90.76%
AVERAGE	107.257	37.76	145.017	173.4	83.63%

Table 1.2: Indirect Tax Revenue by Tax Type

ACTIVITY	REVENUE 2016 (RM MIL)	%	REVENUE 2015 (RM MIL)	%	REVENUE 2014 (RM MIL)	%
GST (Domestic)	41,295	54.20	23,975	38.70	-	-
GST (Import)	18,692	24.53	13,948	22.51	-	-
Excise Duties (Domestic)	7,721	10.13	7,993	12.90	8,456	24.02
Excise Duties (Import)	3,975	5.22	3,890	6.28	4,468	12.69
Import Duties	2,903	3.81	2,737	4.42	2,668	7.58
Export Duties	980	1.29	1,032	1.67	1,898	5.39
Levy	160	0.21	163	0.26	165	0.47
Extraordinary Profit Levy	86	0.11	-	-	51	0.14
Service Tax	103	0.14	3,037	4.90	6,278	17.84
Sales Tax (Domestic)	56	0.07	3,208	5.18	6,131	17.42
Sales Tax (Import)	-	-	1,703	2.75	4,806	13.65
Non-Tax Revenue	91	0.12	119	0.19	135	0.38
States Revenue	135	0.18	145	0.23	141	0.40
Total	76,197	100	61,950	100	35,197	100

Shinkafi & Ali (2017) emphasize that the major thoughtfulness of Islamic economy and finance are human and social welfare, consumption, wealth spending (distribution and management), monetary policies, debts, market exchange, taxation, social security, investment and capital, business and trade, commerce and industry, law of transactions, etc.

They further consider Islamic economy as:

“... a field of knowledge that prepares the realisation of human well-being through allocation and distribution of scarce resources that conform with the Islamic point of view without unduly curbing individual freedom or creating continued macroeconomic and ecological imbalances...”

It has been mentioned early in Al-Quran in verse Q65:7 as follows:

“... Let a man of wealth spend from his wealth, and he whose provision is restricted - let him spend from what Allah has given him. Allah does not charge a soul except [according to] what He has given it. Allah will bring about, after hardship, ease ...”

(Sahih International: At-Talaq 65:7)

Al Azraq & Ahmad (1980) mentioned that Siyasa Syariah is a complete guidance for humankind including a fair and justice manner in wealth management, either in the process of acquiring it or in the process of spending it. Verse Q2:188 in the Quran provides a comprehensive and clear statement on this matter as cited below:

“... And do not consume one another's wealth unjustly or send it [in bribery] to the rulers in order that [they might aid] you [to] consume a portion of the wealth of the people in sin, while you know [it is unlawful]...”

(Sahih International: Al-Baqarah 2:188)

Islamic scholars agree that economic affairs are to be managed so as to provide social and economic justice to citizens (Zaman, 2008). Pertaining to the tax matters, contrasting views on the imposition of tax by the government continue to be debated (Rosman, Mohd Yusof, Abu, & Syed Abdullah, 2015). The first group who consider the act as Haram (forbidden) based on the Quranic verse below:

“... And O my people, give full measure and weight in justice and do not deprive the people of their due and do not commit abuse on the earth, spreading corruption...”

(Sahih International: Al-Hud 11:85)

The following hadith and verse of Al-Quran acknowledge the impose of other forms of tax which did not mention in Al-Quran or practiced by Prophet Muhammad (Peace Be Upon Him):

“... It was reported by Fatimah binti Qais, Prophet Muhammad (Peace Be Upon Him) said: Indeed, there is a due on property other than zakah (Narrated by Al-Tirmidhi, Hadith 659). Then Prophet Muhammad (Peace Be Upon Him) recited the following verses:

Righteousness is not that you turn your faces toward the east or the west, but [true] righteousness is [in] one who believes in Allah, the Last Day, the angels, the Book, and the prophets and gives wealth, in spite of love for it, to relatives, orphans, the needy, the traveller, those who ask [for help], and for freeing slaves; [and who] establishes prayer and gives zakah; [those who] fulfil their promise when they promise; and [those who] are patient in poverty and hardship and during battle. Those are the ones who have been true, and it is those who are the righteous...”

(Sahih International: Al-Baqarah 2:177)

Mauluddin (2015), reinstate Islamic Scholars thoughts, namely Yusuf Al-Qardhawi and Chapra that Zakat limits its distribution to ‘asnaf’ as stated in Al-Quran. Meanwhile, tax being

imposed to finance nation's expenses. Al-Qardhawi outlines 4 conditions of just / fair tax and must be supported by all citizens, i.e. tax as a means of income for nation's wealth and there are no other sources available, just and fair burden among taxpayers, income collected is to be used for the wellbeing of the citizens and not for sinful use, and finally consent from Islamic Scholars and experts to be sought before imposing such tax. While Chapra outlines 3 conditions of just in imposing tax; tax imposed to finance necessity needs for the sake of realising 'maqasid syariah', an affordable rate not to burden the citizens and impose equally among eligible taxpayers, and to use the collections diligently.

Hence, in fulfilling the state obligations to manage the country and at the same time meeting the basic needs / welfare of its citizens, it is timely to relook at the indirect tax policy implemented in Malaysia from Islamic Syariah perspectives.

LITERATURE REVIEW

The conflict over taxation issues i.e. legality of the government to impose tax, the determination of which assets and activities should be taxed, at what rate, and who should pay these taxes can be traced back as early as the time of Prophet Muhammad (PBUH) (Shaban, 1976) until recently introduced Goods & Services Tax in Malaysia (Rosman, Mohd Yusof, Abu, & Syed Abdullah, 2015).

Findings from Shinkafi & Ali (2017) exposed and approved the commitment of contemporary scholars about Maqasid As-Syariah that has a direct connection with Islamic economics, finance, banking and economic development. However, in Islamic economics area, they found that recent academic literatures include more of Zakat and Waqaf; and limited or lack attention given by researchers on the expanses of wealth formation and management, wealth consumption, socioeconomic security, and others.

This is also emphasized by Rosman, Mohd Yusof, Abu, & Syed Abdullah (2015) during the introduction Goods & Services Tax in Malaysia. On the domestic front, Malaysian Fatwa Committee in 2014 passed a resolution that the government is allowed to impose tax as long as there is the necessity to do so, but in accordance with the Syara' parameters. They recommended that there is a need to explore further on a system known as indirect tax and at the same time to explore current practices which impose tax to everybody without differentiating one's wealth. The researcher however did not evaluate to what extent our current practice of taxation complies with syariah principles and conditions.

Previous literatures seem to be in the agreement that there is a need to have an ideal tax system and to find an alternative towards Islamic compliance tax system. However, it associated with Value Added Tax or Goods & Services Tax only and has not given a comprehensive to each indirect tax i.e. import duty, export duty, excise duty, goods & services tax, etc. Studies by Johari & Ibrahim (2010) found that the principle of affordable tax and ethical practice of tax collectors were stressed based on the changes in policies. They further recommend emulating past Muslim Leaders footsteps by taking into account the affordability and burden factor in formulating tax policy because it will affect taxpayers and Malaysians citizen in general.

From Islamic perspective, the conflict over taxation issues is considered as *siyasa* *syariah* issues. *Siyasa* *Syariah* is syariah-oriented policy imposed by the leader in accordance with Islamic law, related to public interest and differs between one country to another country (Syaltut, 2004). The term *Syariah* literally mean path, way or Islamic law. In its collective

application, as defined by Kamali (2008) and cited by Shinkafi & Ali (2017) it means a strict submission to Allah's instructions, guidance and principles that have addressed mankind on matters that relate to their behaviour in this world and salvation in the next.

Yusof (1994) wrote in his book about the experiment on pre-historical aspect, relevancy, administrative, simple technical aspect and issues of tax system in comparison of modern and Islamic perspective. He reiterates Adam Smith main principles of tax system i.e. equal benefit between taxpayers and nation, affordability in term of time and total revenue, Ease of paying tax to the taxpayers and economical in revenue collections. He also observes tax system from the perspective of Rasulullah (PBUH), Ar-Rasyidin, Ibnu Khaldun, Al-Qardhawi etc. Johari & Ibrahim (2010) conclude that "the dynamism of the tax system al-kharaj began with the *ijtihad* by Caliph Umar al-Khattab and hence it evolved its own philosophy of terminology.

This was a system that was retained from the past practice through a dynamic revolution based on Islamic principles that was maintained by past leaders." This study highlighted that the principle of affordable tax and ethical practice of tax collectors were stressed based on the changes in policies. They further recommend to emulates past Muslim Leaders footsteps by taking into accounts the affordability and burden factor in formulating tax policy because it will affect taxpayers and Malaysians citizen in general. Previous research conducted on indirect tax concentrate more on al-kharaj (Johari & Ibrahim, 2010), al-jizyah (BBC, 2012), Waqf, Zakat & Baitulmal (Abd Ghani & Othman, 2016), hence a specific framework on indirect tax could assist policy maker in formulating the policy in Malaysia.

Elgaroshi & Musa (2013) explore the previous research that focus on tax evasion in Islamic law and the provision of the Malaysian Income Tax Act No. 53, 1967, in addition to all relevant laws relating to tax evasion. They found that there are multiple reasons for tax evasion based on moral, administrative, and legal ground. They also note that tax justice as basis of the capacity of the taxpayer is firm in Syariah and Malaysian law as well, and there are similarities between the two systems. They further recommend to adopts the Islamic law (Syariah) within Malaysian legislation as a direct source of income tax legislation. To improve further by including some of the Islamic principles that are commensurate with the nature of the Malaysian Muslim community and to meet the desire of the generations in preparation for the adoption of a fully Islamic financial system. They suggested on improving public expenditure further, so that income holders feel the importance of paying tax, and not to commit evasion, as they would be among the beneficiaries of the payment of such duty.

As mentioned earlier, an indirect tax is collected by mediators who then transfer the amount collected to the government (Encyclopedia Britannia, retrieved 2016). However, previous literature studies on indirect tax have not given a comprehensive to each indirect tax type i.e. import duty, export duty, excise duty, goods & services tax etc. Exploring the literature on Indirect Tax in the database of Universiti Utara Malaysia Library Catalogue resulted only 58 publications related to the subject. Most of the literatures associated with Value Added Tax or Goods & Services Tax only.

Yonah & Margalioth (2006) reviews some recent papers that support the conventional wisdom for developing countries to replace trade taxes with domestic consumption tax (particularly value-added tax or VAT) while maintaining high corporate income tax rates in order to achieve economic growth (efficiency") and social justice (equity"). Literature supporting the conventional wisdom as cited by them includes Gemmell & Morrissey (2003) conclude that the available evidence to suggest that sales tax slightly more progressive or less

regressive than taxes on imports. Another remarkable conclusion is the tax reforms based on conventional wisdom will not have worsened the effects of the tax structure on distribution and the poor. They are in the view that the important implication for tax policy based on distribution and poverty, that taxes on goods that are most important in the consumption bundles of the poor should be kept as low as possible.

On the other perspective, literature criticizing the conventional wisdom as cited by Yonah & Margalioth (2006) includes research done by Emran & Stiglitz (2005) who argue that the conventional wisdom was built on fragile results derived from partial model that ignores the high existence of an informal sector in developing country. The results from a more complete model found that replacing trade taxes with VAT can reduce welfare under plausible assumptions. In addition, they argue that trade taxes enjoy a clear advantage over VAT due to administrative costs and less vulnerable to smuggling. They further cited Baunsgaard & Keen (2005) analysis on panel data for 111 countries for a period of 25 years: from 1975 to 2000. The analysis shows that developing countries find it very difficult to replace the revenue lost by trade liberalization with revenue from domestic sources due to extremely weak revenue recovery as these countries highly dependent on trade tax revenues. Yonah & Margalioth (2006) conclude that a good tax system is one that fits the social institutions as well as other specific determinants of distribution and economic growth in each country. Based on the literature, there seems to be a general agreement that consumption tax is superior to income tax in developing countries in terms of efficiency as well as redistribution, but that corporate taxes should be withheld.

Good governance in the implementation of indirect tax policy is crucial to ensure the people wellbeing in Malaysia. Rosman, Mohd Yusof, Abu, & Syed Abdullah (2015) conclude that source of income from taxation to the nation and its distribution falls under *siyasaah syariah*. Two (2) type of sources namely from *wahyu* (Zakat, *jizyah* and *waqf*) and from *ijtihad* (*kharaj*, '*usyur* etc). There is no substantial difference in imposing tax from the Prophet Muhammad (PBUH) era and Khulafak Arrasyidin era because it was based on *syara'*. In Malaysian context, Fatwa Committee Conference in 2014 agreed that the government is allowed to impose tax as long as there is the necessity to do so in accordance with *syara'* parameters. They recommended that there is a need to explore further on a system known as indirect tax and at the same time to explore current practices which impose tax to everybody without differentiating one's wealth (Rosman, Mohd Yusof, Abu, & Syed Abdullah, 2015). Abu Yusuf Yaqub bin Ibrahim's ideas regarding the mobilization of economic resources based on the principle of Islamic ideology recommended the imposition of taxes which conform the principles of Islamic *Syariah*. With reference to the verses of Al-Quran, Sunnah of the Prophet, and the practices of Ar-Rasyidin, Abu Yusuf suggested to the then Ruler to impose taxes which can serve the interests of the state, citizens and cause the economy to develop (Azmi, 1995).

METHODOLOGY

This study employed library research to achieve the objective of the study through analysis of documents and close group interview. Furthermore, this study also adopted content analysis from secondary source based on data collected from rules, law as well as in-depth interview with Deputy Finance Minister, Malaysian National Fatwa Committee, Deputy Secretary General of Treasury (Policy), Director General of Royal Malaysian Customs Department and

Tax Division Section Head (Indirect Tax) Ministry of Finance and pre-determined officers from Royal Malaysian Customs Department. The information gathered and analysed could enable to explain the practices of indirect taxations in Malaysia as compared to the Syariah principles. The framework drawn based on the thematic content analysis from the above-mentioned method employed and the proposed practical system of indirect tax in Malaysia based on Syariah principles will be confirmed by experts from academic and practitioner scholars.

FINDING

The aim of this paper is to provide a conceptual framework of indirect taxation system from Syariah perspectives. The framework is developed based on the thought by 3 well-known Islamic Scholars in the field of Public Finance particularly in indirect taxation system which are Abu Yusuf Yaqub bin Ibrahim, Al-Qardawi and Chapra. The finding of this study is based on the thematic content analysis method adopted to the information gathered from the agencies mentioned in the methodology section above.

Figure 1 shows the proposed framework of indirect taxation system from Syariah perspectives. As can be seen in the Figure 1, there are four categories (showed in column) which are (i) Root/Base of Ijtihad which is Al-Quran and Sunnah. While (ii) is Huqum of taxation which are contain 5 principles - Fairness, Justice, Equity, Convenience and Ability to Pay. The (iii) is Principles of a Good Tax Policy which are out lined in 6 principles - Quality of Tax Administrations, Just, Honest & Lenient to Taxpayers, Defining Tax Base & Tax Rates, Approach to the Tax Equity, Flexibility in Imposing of the Taxes, Fair Distribution of Income. Meanwhile the (iv) is objectives of a good tax policy which contain Maintenance of Healthy Treasury and Protection of The Public Interest. This framework is comprehensive which ideally and conceptually the indirect taxation system should in line or full fill all the principles in the categories. Not only that, the sequence also should follow the category from each column to each column then only the taxation system can achieve the objectives of the system implementation.

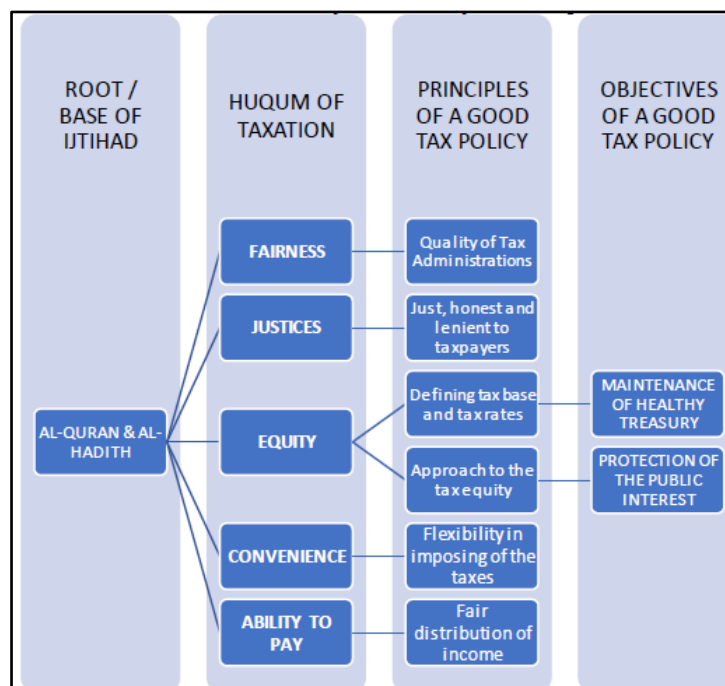


Figure 1: Framework of Indirect Taxation System from Syariah Perspectives

CONCLUSION

As noted in the earlier discussion, the fiscal policy and development of public finance based on Syariah principles have been practiced by Prophet Muhammad (PBUH) followed by Caliphs and past leaders. However, only in eight century A.D. that the manuscript of the fiscal system being written by Abu Yusuf Yaqub bin Ibrahim, the Chief Justice of Abbasid Caliphate. With active involvement in public life and practical problems, his works represent high degree of pragmatism and practical wisdom. His work outlines the fiscal system which emphasized the economic responsibilities of the ruler, principles of efficiency, equity, and justice in tax administration.

Abu Yusuf suggested that the economic life of people is the role of the state which the state should work for the general prosperity of the people while maintaining growth of the economy. Some of the important functions of the state is to ensure the efficiency and equity of tax collection as well as proper administration of public revenue and expenditure. He stressed the need to preserve the individual interest as well as the requirement of the treasury in suggesting the imposition of different taxes.

His economic thoughts derived from noble source of Al-Quran, practice of the Prophet (As-Sunnah) and Caliphs especially Caliph Umar and laid down the principles of fairness, justices, equity, convenience, and ability to pay in outlining / imposing taxes. Ultimately, it fulfils the state obligations to protect the interest of the people and benefit of the treasury.

The framework provided a comprehensive and practical guidance to the policy maker in formulating Shariah-based indirect taxation policies in Malaysia. Good governance in the implementation of indirect tax policy is important to ensure the well-being of Malaysian and Ummah. Its significance to an academic field where lack of empirical study conducted to ascertain the syariah compliance of the current practices in Malaysian indirect taxation. Furthermore, the public in general will indirectly benefit from this study as the tax authority is functioning based on Syariah principles.

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