Ending Exploitative Taxation: A Zakat-Based System for Justice, Economic Growth, & Welfare for All

Amna Hammad

Student of LLB part 1, University of Sindh, Jamshoro[1]

Abstract

This study examines Pakistan's regressive and inequitable taxation system, revealing how heavy reliance on indirect taxes such as GST, petroleum levies, and withholding taxes places a disproportionate burden on low-income households. The research demonstrates how this structure suppresses purchasing power, fuels cost-push inflation, entrenches inequality, and undermines public trust while contradicting constitutional obligations requiring Shariah compliance. The analysis explores the constitutional and legal tensions created by Pakistan's reliance on riba-based debt, despite Article 227's mandate for Islamic conformity and repeated Federal Shariat Court rulings declaring interest unlawful. This section highlights how the debt-tax nexus structurally forces the state toward exploitative revenue measures. The research evaluates Muslim jurists' position that the fundamental distinction between Zakat and taxation lies in their bases of assessment: Zakat falls on annual accumulated wealth, while taxation largely targets income. Because surplus wealth taxation places greater responsibility on the affluent, while indirect taxes fall heavier on the poor, jurists argue that Zakat achieves superior equity and social justice. A comparison between Pakistan's institutional model and Malaysia's professionally governed, technologically advanced Zakat system follows, extracting lessons on governance, digital integration, enforcement, and poverty-focused distribution. The study concludes with a comprehensive transition proposal to a Zakat-centered fiscal framework through legal harmonization, establishment of an autonomous Zakat Authority, blockchain-enabled digital platforms, redefined nisab and asset coverage, and integrated welfare mechanisms including Zakat, Waqf, and Qard-e-Hasan. This research offers an actionable blueprint for shifting Pakistan away from a debt-driven, regressive tax regime toward a stable, equitable, and Shariah-compliant economic system grounded in justice and welfare.

Keywords: Zakat-Based Fiscal System, Exploitative Taxation in Pakistan, Islamic Economic System, Zakat, Economic Growth, Prosperity, Zakat vs Taxation, Pakistan Tax Reform

[1] Author email address: aannakhann@gmail.com

Islamic Model, Malaysia Zakat System Comparison, Islamic Social Welfare System, Wealth Redistribution, Islam, Zakat Implementation Challenges Pakistan

Introduction

Pakistan's fiscal system operates through a taxation approach widely seen as regressive and exploitative. This creates deep public frustration while widening the gap between rich and poor. The government leans heavily on indirect taxes, which hit lower-income families hardest, yet fails to tackle economic problems or build fair growth.

Citizens in Pakistan's major cities deal with an everyday tax burden that's both complex and often senseless. They pay General Sales Tax (GST) on basic necessities, face multiple surcharges, encounter various withholding taxes, and watch utility bills climb. Indirect taxes like GST make up a huge chunk of total tax revenue, with research showing GST hits all income levels regressively (Ara, 2024). What's worse, withholding taxes get slapped on expenses instead of income – a backwards practice that goes against basic income tax logic (Haque & Khan, 2025). Rising prices from petroleum and food cost increases, combined with these pervasive indirect taxes, leave people exhausted and angry. This tax structure also hurts industrial growth and pushes up consumer costs.

Regressive taxation happens when taxes take a bigger bite from poor people's income than from wealthy people's income. Pakistan's system, carrying baggage from colonial times, clearly shows regressive and exploitative patterns.

Key examples include:

• GST on Essentials: Taxing basic needs like food through General Sales Tax hits poor households hardest, since they spend most of their money on these items.

• Withholding Taxes: These get applied illogically to expenses like buying cars, withdrawing cash, or using cell phones rather than targeting actual income. They create unfair financial pressure.

• Fuel/Energy Surcharges: Extra charges on fuel and energy, including Fuel Price Adjustment and Quarterly Tariff Adjustment, directly drive up living and production costs, fueling inflation and eating away at what people can afford.

Pakistan's regressive tax structure creates serious social and economic damage. Heavy indirect taxes, surcharges, and inflation slash the spending money of poor families, making it harder for them to buy necessities (O’Donoghue et al., 2023). Taxes on fuel and other inputs cause supply chain inflation, raising production costs and consumer prices – hitting the poor hardest (O’Donoghue et al., 2023). The obvious unfairness breeds social tension and anger, as poor people carry heavy burdens while wealthy elites find ways around taxes, sparking political unrest and blocking economic growth (Khan & Padda, 2021).

Problem Statement

Pakistan’s fiscal system faces a crisis of economic justice built on structurally regressive and exploitative taxation (Mirza et al., 2018). The heavy use of indirect taxes stems directly from needing to service expensive, interest-based (riba) debt, especially from the IMF, which demands massive, immediate revenue generation.

This creates a basic constitutional conflict: Article 227 requires all laws to follow Shariah, yet the economy depends on riba. This directive lost power when the Federal Shariat Court’s landmark judgment against riba got legally pushed aside. This study examines the structural problems in Pakistan’s conventional, regressive taxation while establishing constitutional and Islamic legal grounds for a Zakat-centered fiscal system. The research provides a detailed legal and institutional roadmap for Zakat implementation.

This work presents a practical academic model to replace conventional taxation, serving as a complete policy framework for basic economic reform that promotes fair growth, poverty reduction, and national debt relief.

Research Questions

This research tackles critical issues around exploitative taxation in Pakistan while exploring workable, Shariah-compliant alternatives. The main research questions are:

How does Pakistan’s regressive tax system drive inequality and instability through crushed purchasing power, supply chain inflation, and social discord?

How does a Zakat-centered fiscal system provide a Shariah-compliant, workable alternative to current exploitative taxation that can promote justice, economic growth, and welfare for everyone?

How do Pakistan’s legal structures block comprehensive Zakat system implementation, and what can we learn from successful Zakat management models, especially Malaysia’s, to overcome these challenges?

THE FAILURE OF PAKISTAN’S FISCAL SYSTEM

Pakistan’s tax structure gets heavy criticism for being regressive, hitting lower-income groups disproportionately hard and adding to economic gaps. This regressivity comes from heavy reliance on indirect taxes, often senseless application of withholding taxes and surcharges, and a direct tax system that puts major pressure on a small group of compliant filers.

Indirect taxes, especially General Sales Tax, make up a big chunk of Pakistan’s total tax revenue – around 60 percent (Ara, 2024). GST hits all income groups regressively. Studies reveal that basic food items carry the highest GST burden, meaning poorer households, who spend more of their income on essentials, carry a heavier relative load (Khan & Padda, 2021). This blanket taxation on necessities drains purchasing power significantly, making income inequality worse.

Pakistan’s taxation system depends heavily on withholding taxes, which contribute significantly to income tax collection but often work like indirect taxation. Instead of just targeting income, WHTs get applied to expenses and transactions like cash withdrawals and cell phone services. This “withholdingisation” builds taxes into the price structure of goods and services, eventually passed to consumers and making domestic products less competitive. Energy-related surcharges, including fuel price adjustments and other charges, help drive up energy costs. These costs then get built into production and transportation, creating higher consumer prices throughout the supply chain.

Direct taxes, mainly income tax, account for a smaller share (38-40 percent) of federal tax revenue compared to indirect taxes (Haque & Khan, 2025). Despite high corporate tax rates in the past, which often discouraged compliance, the tax-to-GDP ratio stays low, and very few people (less than 1%) pay income tax. This creates a situation where disproportionate burden falls on compliant, honest filers, both individuals and corporations. While “Super Tax” isn’t explicitly detailed in available information, the historical context of extremely high corporate rates and the general observation of a narrow tax base mean that a concentrated group of taxpayers bears most direct tax collection, creating perceptions of unfairness and discouraging broader compliance (Hassan et al., 2021).

ECONOMIC AND SOCIAL IMPACT OF REGRESSIVE TAXATION

Pakistan’s regressive tax structure creates several harmful economic effects, blocking sustainable growth and keeping socio-economic problems alive. These impacts show up as suppressed demand, inflationary pressures, and a deepening debt crisis.

Regressive taxation, marked by heavy reliance on indirect taxes like General Sales Tax (GST) on essential goods, hits lower-income households disproportionately hard. Since these households spend a larger percentage of their income on necessities, such taxes effectively cut their disposable income and purchasing power [Ara, 2024; Khan & Padda, 2021; Mirza et al., 2018]. This purchasing power suppression directly reduces aggregate demand in the economy. When consumers have less money to spend, overall consumption drops, ultimately blocking economic growth. GST’s overall impact in Pakistan has been found regressive across all income levels, showing how the tax system compounds income inequality and reduces welfare benefits for the poor. This can negatively impact GDP by reducing investment and household consumption.

Regressive tax policies contribute significantly to cost-push inflation and supply chain distortions. Taxes on intermediate inputs create cascading effects that raise production costs even if the final product is exempt (Ara, 2024). Withholding taxes, often applied to expenses rather than income, also build costs into goods and services, which then get passed to consumers (Ahmed, 2020; Haque & Khan, 2025). Energy-related surcharges, including fuel price adjustments along with other fuel charges, contribute to rising energy costs (Subhani et al., 2024). This rise in input costs forces producers to raise prices, leading to cost-push inflation. High and persistent inflation acts as a regressive tax itself, hitting the poor disproportionately and eroding their savings. Both direct and indirect taxes have been found to significantly increase inflation in Pakistan. Upstream withholding of taxes in the energy sector adds to the cascading effect of indirect taxation.

Pakistan’s fiscal structure, marked by low tax-to-GDP ratios and a narrow tax base, often results in insufficient domestic revenue generation. This persistent revenue-expenditure gap requires extensive borrowing, creating a “perpetual debt trap” (“Sources of Public Finance in an Islamic Economy,” 2010). When domestic resources fall short, successive governments frequently approach international financial institutions, such as the International Monetary Fund (IMF), for loans (Hussain et al., 2022; Khan & Padda, 2021). This reliance on external borrowing, often interest-based (riba), makes the national debt burden worse and limits future policy options. A significant portion of government resources then gets diverted to service this compounded debt, rather than going to development initiatives. This cycle of low revenue, external borrowing, and debt servicing traps Pakistan deeper in financial trouble, leading to higher sovereign debt. Pakistan's Constitution, through Article 227, also mandates eliminating interest (riba) from the economy.

Pakistan's tax system's nature goes beyond economic numbers, deeply affecting social unity and psychological well-being. It erodes public trust, makes economic hardship worse, and keeps a sense of injustice alive through elite capture. Citizens hold a "disgruntled notion" that political and economic elites consistently dodge their fair share of taxes, often engaging in corrupt fiscal deals (Malik, 2019). This perception gets reinforced by weak tax enforcement, widespread corruption within the tax machinery, and using political influence to avoid tax obligations. The reliance on indirect taxes, which disproportionately burden compliant individuals and small businesses, while large sectors like agriculture (whose profits often go to wealthy landowners and parliamentarians) stay largely exempt, creates a strong sense of injustice (Hassan et al., 2021). This unfair distribution of tax burden, alongside lack of transparency and accountability, breaks the social contract between state and citizens, discouraging voluntary compliance and leading to low tax morale.

Economic hardship imposed by regressive taxation directly connects with increased social strain and, sometimes, rising criminal activities. By disproportionately burdening lower-income households with indirect taxes on essential goods, the tax system reduces their disposable income and compounds income inequality (Mirza et al., 2018). This suppressed purchasing power, coupled with inflationary pressures, makes it increasingly hard for individuals to meet basic needs (Ara, 2024) Such economic misery and inequality are recognized drivers of social unrest and have been found to have a positive and significant impact on crime rates, particularly property crimes, in Pakistan (Ali & Bibi, 2020; Khan et al., 2015). Studies show a strong link between unemployment, low income, poverty, and increased criminal behavior, as individuals may turn to illegal activities when legitimate opportunities shrink.

This system often gets characterized by "elite capture," where powerful groups, including wealthy landowners and large corporations, benefit from tax exemptions, concessions, and loopholes, while the burden falls heavily on middle and lower classes (Khan & Padda, 2021). For instance, the agriculture sector, despite its significant economic contribution and profits often going to affluent individuals, remains largely untaxed. Similarly, large corporate entities frequently use aggressive tax avoidance strategies, sometimes by falsely classifying income sources or exploiting loopholes. Measures like tax amnesty schemes have historically been seen as benefiting elites by allowing them to regularize undeclared assets with minimal penalties. This keeps alive a system where politically influential groups can steer tax policy to their advantage, leaving most of the population, especially the middle class, to shoulder an unfair proportion of national revenue needs (Ahmad, 2010; Malik, 2019).

CONSTITUTIONAL AND LEGAL DIMENSIONS

Pakistan's legal system mandates Shariah compliance, yet faces ongoing conflict, especially regarding the prohibition of interest (riba). Pakistan's Constitution declares Islam as the State religion and mandates that all laws conform to Islamic injunctions from the Holy Quran and Sunnah. The Objectives Resolution, constitutionalized as Article 2A, reinforces this, making Islam a guiding principle for all laws. The Federal Shariat Court was established to ensure Islamization of laws by reviewing legislation for Shariah conformity.

The FSC (Federal Shariat Court) has repeatedly ruled that interest (riba) violates Islamic principles. Back in 1991, it declared the entire interest-based banking system un-Islamic (Mansoori & Ayub, 2022). The Supreme Court's Shariat Appellate Bench initially backed this decision in 1999, ordering all interest-related laws to stop working (Ghafoor, 2022). But things got complicated when a review petition caused a new SAB to send the case back to the FSC in 2002. That same year, the FSC doubled down, ruling that every form of riba, including commercial interest, is forbidden and demanding an equitable Islamic economic system. This shows how the courts have stuck to their anti-riba position, even with all the messy legal and political hurdles that come with overhauling an entire financial system.

FOUNDATIONS OF AN ISLAMIC FISCAL SYSTEM

An Islamic fiscal system builds on Zakat and follows principles of justice and benevolence, creating a different way to manage economics that aims for fair wealth distribution and better overall welfare.

Zakat and regular taxation both require mandatory payments, but they come from completely different philosophies and serve different purposes. Zakat is religious giving that eligible Muslims must do. It's meant to purify wealth, earn blessings, and help specific groups of needy people that the Quran identifies. Zakat goes after surplus wealth, not income or what you spend, at set rates like 2.5% on accumulated wealth. Its main job is redistributing wealth and fighting poverty. It works like a social welfare tool that gets demand and production moving.

Regular taxation works differently. Governments impose it to pay for all sorts of public spending like roads, defense, and social services that benefit everyone regardless of their faith. Taxes usually target what you earn and spend, often including basics, which can hit lower-income people harder. While taxes can help reduce inequality, they're mainly about raising revenue, with rates and what gets taxed being flexible and decided by lawmakers.

Zakat vs Taxation – Comparative Table:

Feature	Zakat	Taxation
Nature	Religious obligation	Government obligation
Purpose	Wealth purification, poverty alleviation, social welfare	Public expenditure funding, economic regulation
Scope	Surplus wealth	Income, consumption, assets
Beneficiaries	Specific Quranic categories	General public
Rates	Fixed (2.5%)	Variable, legislative

Islamic economic principles rest on Adl (justice) and Ihsan (benevolence). Adl means fairness, equity, and treating everyone impartially in all economic dealings. It requires fair wealth distribution and opportunities, making sure people get treated right, conduct themselves ethically, and resolve disputes without bias. This principle demands transparent transactions and bans exploitation.

Ihsan, or benevolence, pushes people to go beyond basic requirements, showing compassion and helping others' welfare. It builds social solidarity, encouraging excellence in actions and strong moral responsibility. Together, Adl and Ihsan work to create a balanced, harmonious, and ethical society where justice gets upheld and everyone's well-being matters.

A vital principle in Islamic economics, highlighted by Surah Al-Hashr (59:7), prevents wealth concentration: "so that it may not be [a benefit] going round and round among such of you as may [already] be rich". This verse shows why wealth needs to circulate widely within the community, helping all members instead of staying with wealthy elites. Islamic economic tools like Zakat, inheritance laws, and the interest ban actively work to redistribute wealth and prevent it from stagnating (Shaikh, 2018). This makes sure resources serve everyone's good, building social justice and economic stability.

ECONOMIC, SOCIAL, AND MORAL DYNAMICS OF ZAKAT

A Zakat-based system works through specific economic mechanisms designed to promote fair wealth distribution, build economic stability, and improve social welfare, which contrasts sharply with regular tax systems.

Zakat stimulates aggregate demand through a powerful multiplier effect. It transfers wealth from rich people (who typically spend less of each additional dollar) to poor and needy people (who spend more of each additional dollar), directly boosting the purchasing power of disadvantaged groups. This redistribution makes sure wealth gets consumed rather than sitting idle, which increases overall spending in the economy. This higher demand then encourages more production and investment, creating a positive multiplier effect on economic growth and employment. Zakat's natural design means this demand boost supports the business cycle against economic downturns without necessarily needing expansionary fiscal or monetary policies that could cause inflation.

Zakat's main economic function includes its built-in mechanism to discourage hoarding idle wealth. Zakat gets levied annually at a fixed rate, typically 2.5%, on accumulated surplus wealth that's stayed idle for a lunar year. This annual charge discourages keeping wealth unproductive; if wealth isn't invested or used productively, Zakat will gradually eat it away over time. So people get incentivized to invest their wealth in productive businesses, making sure capital keeps circulating within the real economy instead of sitting around. This mechanism ensures wealth actively contributes to economic activity, turning idle savings into investments and consumption.

A Zakat-based system can help stabilize prices, especially when it replaces regressive indirect taxes. Regular indirect taxes, like Value Added Tax, get calculated on goods' prices, directly increasing their cost and adding to inflationary pressure. Zakat, however, gets levied on wealth or business results, not directly on goods' prices. While distributing Zakat might initially increase aggregate demand, a matching increase in aggregate supply (driven by increased productivity and investment that the Zakat system encourages) can balance this, leading to price stability. Plus, Zakat's flexibility and built-in provisions help stabilize currency purchasing power and protect the economy from inflationary and recessionary pressures (الهاشمي, 2024).

Waqf (endowment) is another important Islamic social finance tool that complements Zakat by providing sustainable funding for long-term infrastructure and welfare projects. Waqf involves dedicating assets (like land, buildings, or cash) permanently for charitable or religious purposes, ensuring a continuous flow of resources for public benefit. Historically and today, Waqf has been essential in establishing and maintaining vital public goods and services, including educational institutions (schools, universities, scholarships, libraries) and healthcare facilities (hospitals, clinics, medical centers). This lasting form of charitable giving creates a strong social safety net and supports long-term societal development, building human capital and overall well-being.

A Zakat-based system also provides significant social and moral benefits, creating a more harmonious society, strengthening public trust in governance, and directly fighting poverty through empowerment. It naturally promotes social cohesion. By requiring a portion of surplus wealth to be distributed to the needy, Zakat builds a spirit of brotherhood and cooperation. It eliminates feelings of envy and hatred that can come from extreme wealth gaps, replacing them with gratitude and love. The act of giving Zakat shows that the rich acknowledge their responsibility toward the community, making sure wealth circulates and benefits all members. This distributive justice narrows the gap between socio-economic classes, preventing social conflict and building shared well-being and solidarity within society. Zakat also builds community and solidarity among Muslims, encouraging the wealthy to support the less fortunate and promoting social justice by redistributing wealth.

Effective and transparent Zakat management can significantly strengthen the moral legitimacy of state institutions. When a state actively helps collect and distribute Zakat, it shows its commitment to social justice and citizen welfare, aligning with Islamic requirements. Public trust in government and Zakat institutions is vital for such a system's success; where this trust is high, compliance and collection rates work better (Wibisono, 2021). For Zakat institutions to keep their legitimacy, they must embrace good governance practices, ensuring accountability and sticking to Shariah objectives. By maintaining these standards, state-backed Zakat management can become a powerful tool for ethical governance, reinforcing its moral authority among the people.

Qard-e-Hasan (benevolent loans) is another important Islamic financial tool for creating livelihoods. These are interest-free loans given to those in need, with borrowers only obligated to return the principal amount. Qard-e-Hasan can be used for micro-financing, supporting small businesses and startups that might otherwise struggle to access regular credit due to lack of collateral or high interest rates. This doesn't just relieve immediate financial burdens but also lets recipients invest in productive ventures, build assets, and contribute to the economy, transforming them from Zakat recipients to potential Zakat payers.

COMPARATIVE ANALYSIS – ZAKAT IN PAKISTAN AND MALAYSIA

Institutional Framework and Challenges in Pakistan's Zakat System

The Zakat and Ushr Ordinance, introduced in Pakistan in 1980, marked a major effort to institutionalize the Islamic fiscal system for social welfare and economic justice. A primary strength was establishing a centralized collection and distribution mechanism, overseen by the Zakat and Ushr Department, with a clear flow of funds from the Central Zakat Fund to provincial, district, and local committees (Ashraf, 2017). This structured approach aimed to reduce wealth disparity, encourage economic growth, and introduce features of an Islamic welfare state by requiring the collection of 2.5% of wealth from eligible Muslims and one-tenth of agricultural produce. The collected funds were intended to directly support the poor and needy.

However, the Ordinance also faced major weaknesses. Its effectiveness in fighting poverty has been questioned, as significant progress in reducing the gap between rich and poor stayed out of reach. The legislation ran into legal challenges, notably the controversial exemption of Shia Muslims from compulsory Zakat deductions following protests, which highlighted implementation and acceptance issues (Sharia Incorporated...). Critics have also argued that the Ordinance, in its practical application and legal interpretations, didn't fully match the comprehensive principles of the Islamic Zakat system, suggesting a need for reform. Many issues regarding its judicial standing and application remain unresolved today (Sharia Incorporated...).

This Zakat and Ushr system operates within a framework that's undergone significant changes, particularly with the 18th Constitutional Amendment in 2010. This amendment shifted powers from the federal to the provincial level, empowering provinces to legislate on

Zakat and Ushr. Federally, the Ministry of Religious Affairs' Zakat and Ushr Wing plays a supporting role for the Central Zakat Council.

The institutional structure is mostly hierarchical, helping the collection and distribution of funds. Zakat collected from financial assets, such as bank accounts, gets channeled into a Central Zakat Fund, managed by the State Bank of Pakistan (Ashraf, 2017). These funds are then distributed to Provincial Zakat Funds, and then to District and Local Zakat Committees, often based on population. These local committees play a key role in delivering Zakat to eligible beneficiaries at the community level, including support for the destitute, widows, education, and healthcare.

Several limitations of this system prevent it from working optimally. A significant challenge is its voluntary nature in many practical applications, made worse by a perceived lack of credibility in the government-run system. This leads to substantial Zakat evasion and a preference for private charity, reducing overall collection efficiency (Malik, 2016). There's also notable reluctance among some to pay Zakat without strong governmental enforcement.

The system's narrow scope is another key limitation. Zakat and Ushr funds are mainly allocated to specific welfare programs, such as education, healthcare, and social support for targeted groups. However, this focus often overlooks a broader range of essential public goods and services necessary for comprehensive societal development. Additionally, the legal framework and its implementation are often criticized for not fully matching the holistic principles of the Islamic Zakat system, indicating a need for reform.

Finally, the post-18th Amendment decentralization, while encouraging provincial autonomy, has inadvertently contributed to a lack of unified central authority and inconsistencies in implementation across the nation. This fragmented approach, coupled with issues like inadequate planning, ineffective implementation, and political considerations, often detracts from the primary goal of poverty alleviation and the system's overall impact.

The Malaysian Model of Zakat Management

Malaysia's Zakat management system operates with a decentralized yet regulated structure, mainly overseen by State Islamic Religious Councils. Each state has its own Zakat institution, leading to diverse operational practices across the country (Meerangani, 2019). For example, institutions such as Majlis Agama Islam Wilayah Persekutuan and Pusat Pungutan Zakat in Federal Territories manage Zakat collection and distribution at the state level, with some states having privatized certain aspects to boost efficiency. Despite this decentralization, the system aims for professionalism, transparency, and accountability in managing Zakat funds. The goal is to make sure these institutions effectively carry out their duties, benefiting eligible recipients (Azhar et al., 2023).

This Zakat system covers a wide range of wealth categories. Zakat applies to income, business earnings, gold, silver, savings, animals, and agricultural produce (Bakar, 2018; Omar et al., 2021; Wijayanti et al., 2022). This broad scope creates an extensive collection base. The Malaysian government boosts compliance by making Zakat payments tax-deductible, which connects religious duties with fiscal policy (Ajahar et al., 2025; Suryani, 2020). This wide-ranging collection, combined with Zakat's socio-economic function, plays a major role in redistributing wealth and reducing poverty in the Muslim community.

Critical Comparison & Lessons for Pakistan

Feature	Pakistan	Malaysia
Legal Framework	Zakat management and tax treatment are primarily governed by the Zakat and Ushr Ordinance of 1980, which introduced compulsory Zakat collection with deduction at source.	Each state in Malaysia enacts its own Zakat laws, with State Islamic Religious Councils managing Zakat affairs. Zakat has been integrated into the tax system since 1967 and specifically as a tax credit (Adriansyah et al., 2021; Syahbandir et al., 2022).
Tax Concession	The amount paid to a Zakat Fund reduces the total income of an assessee for tax liability purposes. Zakat deducted at source from savings accounts, and assets from which Zakat has been deducted, are excluded from taxable wealth. Zakat acts as	Zakat payments are treated as a tax rebate, directly reducing income tax payable rather than merely being a deductible expense (Adriansyah et al., 2021). This can be up to 100% of the Zakat paid, provided it is evidenced by a receipt from

	a fiscal incentive to reduce taxable income (Islamy & Aninnas, 2020).	an appropriate religious authority (Wijayanti et al., 2022). The rebate amount is limited to the total income tax for the assessment year.
Corporate Zakat	Zakat is collected on certain assets from “Sahib-e-Nisab” entities, with exemptions for government-owned or majority-shared institutions.	Companies paying Zakat to SIRCs can claim an allowable deduction in corporate tax computation, typically limited to 2.5% of their aggregate income (Talattov et al., 2016).

Comparing Zakat management in Pakistan and Malaysia shows different approaches shaped by legal frameworks, institutional structures, and social contexts. Both countries want to use Zakat for socio-economic development, but Malaysia’s model often appears more organized, professionally managed, and Shariah-compliant, providing useful lessons for Pakistan.

Malaysia’s Zakat management operates through a decentralized yet professionally organized system, mainly run by State Islamic Religious Councils in each state. These SIRCs function as statutory bodies, handling Zakat collection, distribution, and administration with considerable autonomy and professionalism. Some states like Selangor have privatized aspects of Zakat management, with dedicated Zakat Collection Centers operating officially. This structure enables focused expertise, efficient operations, and responsiveness to local needs within a national framework (Mukhlishin et al., 2024). Pakistan’s Zakat system, established by the Zakat and Ushr Ordinance of 1980, centralizes operations under the Central Zakat Fund with provincial councils. The CZF includes a Supreme Court Justice, Islamic scholars, and government officials. While this structure provides national oversight, the system has faced challenges with bureaucratic inefficiencies, public distrust, and problems with timely distribution (Saikhu, 2024). Government bureaucracy involvement can cause delays and reduce operational flexibility compared to Malaysia’s specialized and semi-autonomous SIRC model.

Malaysia enforces a comprehensive, semi-compulsory Zakat collection system. Income Zakat is often deducted directly from employee salaries, making it mandatory. Zakat payments also qualify for tax rebates, which strongly incentivizes contributions by directly reducing income tax liability (Syahbandir et al., 2022). This policy has improved collection across various Zakat categories, including business, income, and savings, expanding the Zakat base. Malaysia's effectiveness also stems from Zakat's tax-deductible status, encouraging Muslims to meet their religious obligations while gaining tax benefits. Though individual Zakat represents a smaller portion, corporate Zakat contributes significantly to overall collection (Migdad, 2019). Pakistan introduced compulsory Zakat collection in 1980, making it an official state matter, especially with automatic deductions for certain assets. However, compulsory collection scope has been narrower than Malaysia's. While Zakat is deducted from savings accounts, other forms like agricultural produce Zakat have faced implementation challenges and exemptions that can limit the collection base (Saikhu, 2024). Pakistani Zakat reduces total income for tax purposes rather than offering direct tax rebates, which may provide different incentive levels compared to Malaysia's system. The voluntary nature of Zakat before 1980 and ongoing discussions suggest a less comprehensive and sometimes disputed compulsory collection mechanism.

Malaysia's Zakat laws, enacted by each state's SIRC, align well with Shariah principles, and management by these councils ensures collection and distribution follow Islamic guidelines. Integrating Zakat into the tax system and managing it through religious authorities reflects efforts to maintain both legal and Islamic integrity. This harmonized approach builds public trust and acceptance of the Zakat system. In Pakistan, while Zakat has constitutional backing, implementation has faced legal conflicts, particularly regarding Federal Shariat Court jurisdiction and various judicial interpretations about Zakat exemptions (Saikhu, 2024). The compulsory nature of Zakat and its collection methods have been challenged in courts, creating complexities that sometimes limit effective implementation of the Zakat and Ushr Ordinance. These legal disputes create uncertainty and impact perceptions of Shariah alignment, potentially affecting compliance.

Malaysia's Zakat institutions prioritize empowering the Asnaf through various socio-economic development programs. These programs go beyond basic support, focusing on sustainable improvement through skills training and business support. Zakat funds are strategically used for economic development initiatives that provide business opportunities and entrepreneurship training to raise Asnaf economic standards. Examples include capital assistance, equipment provision, and training guidance, all aimed at fostering self-sufficiency and transforming recipients into contributors. Efforts ensure Zakat funds support long-term productive use, contributing to sustainable Asnaf development (Haq et al., 2021). Some Zakat institutions even develop religious conditions for conditional cash transfers to promote human capital development. While Pakistani Zakat aims for poverty reduction, challenges appear in distribution and social safety net impact. Pakistan lacks specific, structured programs for skills development and entrepreneurial support for Zakat recipients comparable to Malaysia's integrated approach.

TRANSITION INTO A ZAKAT BASED FISCAL SYSTEM: LEGAL, CONSTITUTIONAL, AND INSTITUTIONAL REFORMS

Pakistan should strengthen Articles 2 and 227 of the Constitution, along with the Federal Shariat Court's judgment on riba, as part of establishing institutional structures essential for a Zakat-based economic system. The Federal Shariat Court has declared riba (interest) un-Islamic and directed the state to eliminate it through strong political commitment, phased implementation, and effective oversight ("Dialogue at IPS," 2023). Effective implementation requires a comprehensive national strategy for Shariah-compliant finance. This includes institutional capacity building within banking and financial institutions, developing Shariah-compliant financial products, enhancing regulatory frameworks, and creating monitoring mechanisms that ensure alignment with Islamic economic principles. Training programs for bankers, regulators, and policymakers would support a gradual but consistent shift away from interest-based toward equity-based and trade-based financial instruments.

The Enforcement of Sharia Act 1991 provides statutory backing for establishing an Islamic economic order. It calls for forming a supervisory commission mandated to oversee riba eradication, ensure financial practices conform to Shariah, and guide the transition toward a system grounded in social justice, wealth redistribution, and Zakat-based welfare (Sharia Incorporated...). Strengthening and operationalizing this supervisory structure is vital for achieving a coherent, enforceable, and sustainable Islamic economic framework in Pakistan.

Indirect taxes like GST dominate Pakistan's revenue, comprising 60% of collections and disproportionately burdening the poor (Ara, 2024). GST incidence averages 6.7%, highly regressive especially on food and utilities across rural-urban divides. Exempt final products still embed input taxes, cascading costs to consumers. Petroleum levies inflate fuel prices, hurting low-income mobility, while withholding taxes on services presume gross receipts as income, embedding costs into goods and eroding competitiveness. Reforms should zero-rate GST on essentials (food, utilities), slash levies, and eliminate withholdings on basics like telecom and cash withdrawals, shifting to progressive alternatives (Haque & Khan, 2025).

Taking inspiration from Caliph Umar ibn al-Khattab’s model, where amils collected via checkpoints yielding surpluses for freeing slaves and aiding marriages, a statutory body should ensure transparent zakat flow. Building on the 1980 Ordinance, post-18th Amendment devolution empowers provinces to legislate, harmonizing with income tax for broader collection and poverty relief. Independence from politics guarantees efficient, targeted distribution.

A robust Zakat authority needs a multidisciplinary governing board comprising economists for macroeconomic modeling and fiscal impact assessments, Shariah scholars for doctrinal compliance, and accountants for financial auditing and transparency protocols. Drawing on Malaysia’s model, boards should feature diverse expertise including stakeholder representatives to address operational challenges and build public confidence. In Pakistan, post-devolution councils could incorporate professional amils trained in Islamic accountability, ensuring ethical decision-making and risk oversight. Such structures, emphasizing Shariah supervision alongside procedural justice, mitigate mismanagement and enhance compliance, mirroring successful Malaysian and Indonesian practices where integrated governance boosts collection efficiency (Sawmar & Mohammed, 2021).

Nisab thresholds must adapt to modern economies, benchmarked at 85 grams of gold or equivalent silver value, adjusted annually for inflation. Applicable assets include cash holdings, bank deposits, gold/silver jewelry beyond personal use, held-for-trade inventory, resale real estate, and financial instruments like stocks (taxed on dividends/capital gains, not principal if invested productively), bonds, mutual funds. Cryptocurrencies qualify as savings or trading goods, subject to 2.5% if exceeding nisab for a lunar year, per fatwa consensus extending Qiyas to emergent wealth. Agricultural output incurs 5-10% ushr; industrial/services production follows similar principles. Standardized fatwas from Ulama councils prevent evasion, promoting equitable coverage.

A unified digital ecosystem should leverage blockchain for immutable traceability and AI for predictive analytics, integrating NADRA’s biometric Ids for beneficiary verification, FBR’s tax filings for muzakki assessment, land records for property evaluation, and bank APIs for balance checks. Smart contracts automate nisab calculations and distributions, curbing duplicates and leakages as in Malaysia’s IT recipient databases or proposed “ZakatTech” platforms. Real-time dashboards foster accountability, slashing admin costs by 30-50% while enabling payroll deductions and e-payments, similar to fintech-driven Malaysian systems.

ZAKAT IMPLEMENTATION FRAMEWORK AND WELFARE PROGRAMS

The foundation must be strong. Funds must strictly target the eight asnaf: fuqara (extreme poor), masakin (needy), amileen (administrators), muallaf (new Muslims), riqab (freeing captives), gharimeen (debtors), fee sabilillah, and ibn sabil (travelers). Audited allocations, capped per category, preserve Shariah purity, with 60-70% typically for direct poverty relief.

Tiered initiatives include unconditional cash for survival, revolving qard-e-hasan microloans (up to PKR 100,000) for startups with 80% repayment rates, and skills hubs offering vocational/digital training in agriculture, IT, and crafts. These empower mustahiq to transition into muzakki, amplifying impact via monitored outcomes.

Complementary cash waqfs endow perpetual assets: community hospitals, technical schools, low-cost housing via revenue-generating farms/markets. These institutions reinvest yields into masarif, creating self-sustaining welfare networks as in historical caliphates.

TRANSITION STRATEGY & DEBT REDUCTION

For 5 years, phase out GST and levies, leveraging zakat’s broad base on wealth for progressive revenue can help in potentially reaching double-digit GDP ratios as proposed in “An Alternate Approach to Theory of Taxation and Sources of Public Finance in an Interest Free Economy,” 2010; “Sources of Public Finance in an Islamic Economy,” 2010.

Using Zakat and Waqf can reduce reliance on IMF loans and riba-based borrowing. Zakat funds can cover fiscal gaps without resorting to deficits, while waqf institutions can finance public services, reducing the need for borrowing and interest payments, helping to escape debt traps.

SUMMARY OF FINDINGS

Pakistan’s tax system relies heavily on regressive indirect taxes, comprising 60% of revenue, with GST as the dominant component imposing a 6.7% average incidence across households.Ara, 2024 This burden falls disproportionately on the poor, especially via taxes on food, utilities, and petroleum, exacerbating inequality and poverty as low-income groups consume a larger income share on taxed essentials (Ara, 2024; Khan & Padda, 2021). Empirical analyses confirm GST’s regressivity in rural and urban areas, cascading through inputs even on exempted goods, stifling growth and welfare.

Zakat emerges as a constitutionally mandated alternative, rooted in Article 2 and Article 227 (no repugnant laws), reinforced by Federal Shariat Court rulings against riba and the Zakat and Ushr Ordinance imposing 2.5% on eligible wealth for redistribution. Post-18th Amendment, provincial devolution enables efficient enforcement, aligning fiscal policy with Shariah for equitable public finance.

Malaysia offers key lessons: centralized institutions excel in collection and technical distribution, benchmarked globally, though sustainability requires databases integrated with welfare systems to avoid duplication and enhance targeting. Digitalization and professional governance have boosted compliance and poverty relief, providing a replicable model for Pakistan.

Policy Recommendations

Enforce Shariah compliance in fiscal frameworks by operationalizing Articles 2 and 227 through riba elimination timelines and Shariah audits.

Establish a statutory autonomous Zakat Authority with multidisciplinary boards, modeled on Caliph Umar-era efficiency and Malaysian councils, for nationwide collection.

Phase out regressive taxes on essentials like GST on food, petroleum levies, and service withholdings over five years, substituting with broad-based zakat.

Digitize collection via NADRA-FBR linked platforms with blockchain audits for transparency and mandatory payroll deductions.

Contribution to Knowledge

This study advances Islamic political economy by integrating Zakat as a viable fiscal pillar, critiquing riba-dependent systems and regressive taxation. It provides a comprehensive blueprint for Pakistan: legal reforms, institutional redesign, tech integration, and welfare programs, bridging theory with actionable policy for justice and growth.

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