

# **BANKING AND TAXATION IN THE NAME OF GOD AND THE LAW**

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The Central Bank of Nigeria on Tuesday 21st June 2011 issued new guidelines for the regulation and supervision of institutions offering non-interest financial services in Nigeria. The CBN stated that the emphasis of this guideline is on non – interest financial institutions operating under the principles of Islamic Commercial Jurisprudence, one of the categories of non- interest financial institutions.

These guidelines, according to the CBN, are issued pursuant to the non- interest banking regime under section 33(1) (b) of the CBN Act 2007; section 23(1);52, ;55(2); 59(1) (a); and 61 of the Banks and Other Financial Institutions Act (BOFIA) 1991(as amended) and section 4(1)(c) of the Regulation on the Scope of Banking Activities and Ancillary Matters, No 3, 2010. It shall be read together with the provisions of other relevant sections of BOFIA 1991(as amended), the CBN Act 2007, Companies and Allied Matters Act (CAMA) 1990 (as amended) and Circulars/Guidelines issued by the CBN from time to time.

The guidelines further provides that Institutions Offering Islamic Financial Services (IIFS) may charge such commissions or fees as may be necessary in accordance with the principles under this model and the funds received as commissions and fees shall constitute the bank's income and shall not be shared with depositors.

In addition, the guideline provides that there shall be compliance with prescribed Audit, Accounting and Disclosure Requirement such as the Nigerian Accounting Standards Board (NASB) and that where there is a conflict between the local and international standards, the provisions of the local standards issued by NASB shall apply to the extent of the inconsistency. This is an interesting provision and one may ask, what will happen if there is a conflict between NASB standards and those of the Islamic Financial Services Board (IFSB) or with those of the Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI)? Will NASB standards prevail? Are the IFSB and AAOIFI international standards by virtue of location or principles? If it is by location, are the Islamic principles, it espouses not local? Do these principles extend to taxation?

Presumably, the commissions and fees which constitute the bank's income as well as the profit sharing investment accounts will be subject to Nigerian taxation. What taxation standards will be applicable? Would it be those of IFSB, AAOIFI, NASB or those of the Chartered Institute of Taxation? Could it even be those of the Relevant Tax Authority who are empowered under both section 62 of CITA LFN 2004 and section 52 PITA LFN 2004 to require in writing that a taxpayer keep such records, books and accounts as maybe considered adequate in such form and in such language (Arabic?) as maybe specified in the said notice? How are the Islamic financial products to be taxed?

While the idea of facilitating faith- based finance may seem economically rational, a fundamental question similar to those asked and resolved by Brett Freudenberg and Mahmood Nathie with respect to Australia,a similar federation to Nigeria, in their work on " The Constitution and Islam: Are Tax Reforms Possible To Facilitate Islamic Finance?" needs to be asked in Nigeria and addressed: Is it appropriate for Nigeria's tax laws to be amended to facilitate what may be construed to be the furtherance of any religion? In other words, should the products of Islamic Banking be taxable by the principles of Islamic taxation?

The recognition of taxation in Islam generally follows the traditions in Judeo-Christian teachings, albeit with some differences. The equivalent of tithes in Islam is the ushr, or a tenth of gross agriculture output - a tax calculated taking into account for instance, whether the land is irrigated naturally or by man. In Islam this tithe is only due when there is a produce, to the extent that when the produce is destroyed by the acts of God, its payment lapses. Thus ushr is a form of tax on income in the sense that it is value of goods (produce) that become the basis of taxable income. The Caliph (the Head of State today) 'has the right to levy on the people the amount needed if

funds are not available in the public treasury'. The ushr was a fixed levy, but the Jurist, Abu Yusuf, in his treatise on taxation in Islam proposed a model of proportional taxation and not fixed levy.

A different variant of the ushr known as the ushur also exists – one introduced by the second Caliph Umar- that resembled a type of sales tax. It was charged to traders who entered the Islamic state to conduct trade.

A third form of taxation in Islam is what is known as kharaj or land tax payable to the state- irrespective of who owns the land. The implications of these tax impositions is that the state's right to tax is legitimized- although this right is not to be assumed to be unfettered.

While Islam does allow the levying of taxes to a reasonable extent to meet all necessary and desirable state expenditures, it does not permit an unjust tax structure which penalizes honesty and creates an un- Islamic tendency of evading taxes.

#### **A country has the right to raise resources through tax collection:**

This right is defended on the basis of the Prophetic saying that 'in your wealth there are also obligations beyond the zakat', and one of the fundamental principles of Islamic Jurisprudence is that 'a small benefit may be sacrificed to attain a larger benefit and a smaller sacrifice may be imposed in order to avoid a larger sacrifice'. Most Jurists have upheld the right of the State to tax. ... If the resources of the State are not sufficient, the State should collect funds from the people to serve the public interest because if the benefit accrues to the people it is their obligation to bear the cost.

While taxation has been accepted as an institutionalized function in the monotheistic faiths, it remains to be seen how these functions converge in Nigerian law.

The norms that characterize Islamic finance may be classified into two dimensions- a moral and ethical dimension, and an economic dimension. The first deals predominantly with socio-economic justice and equitable distribution through tax by way of Zakat (obligatory alms) and the prohibition of trading in forbidden objects and hoarding. The economic dimension incorporates a number of distinct elements namely:

Freedom to contract;

Freedom from riba (interest);

Gharar or excessive speculation and uncertainty;

Freedom from al-qimar (gambling) and al-maysir (unearned income);

Trading and investment in forbidden acts and objects (such as gambling, pornography and alcohol)

Duality of risk (parties must share risk); and

Asset – based financial transactions, based on the condition that identifiable and tangible underlying assets should underpin financial transactions.

The juristic principles underpinning these elements are vast and extant and transcend into very fine detail over which there is no unanimity among the four leading Islamic juristic schools. Thus, as a means of standardizing these principles, the Islamic Financial Services Board and the Accounting and Auditing for Islamic Financial Institutions (AAOIFI) have compiled detailed guidelines for practitioners to follow in the application of Islamic finance.

Among the financial products frequently referred to in Islamic financial contracts are murabaha or (cost-plus) financial transactions; ijara contracts (leasing contracts); mudarabah contracts (trustee partnership); musharaka contracts (forms of limited partnership); sukuks (Islamic bonds); and takaful (mutual insurance arrangement).

The practical manifestation of these products within Islamic banking institutions is accomplished with the assistance of both sharia scholars and conventional legal practitioners. This additional regulatory layer is meant to guide financial institutions to ensure compliance with the sharia in their financial activities. For this reason, Islamic banks are required in many jurisdictions to establish sharia supervisory boards or committees.

The influence of religion in our corporate existence as a nation is illustrated by the existence at the beginning of the 1999 Nigerian Constitution of a preamble which may be described as a 'constitutional obeisance to God'. The preamble reads:

“ We the people of the Federal Republic of Nigeria, having firmly and solemnly resolve, to live in unity and harmony as one indivisible and indissoluble sovereign nation under God”.

It appears that wording of the preamble was intended to appeal to those voters of religious conviction for the formation of a Federation.

Another very clear connection between the Nigerian State and religion are the current practices at State functions where each function begins with two prayers- one an Islamic prayer and the other the Christian prayer. This practice of prayer commencing State functions is not unique to Nigeria, as other common law jurisdictions such as Australia, New Zealand, Canada, the UK and the United States also do this.

A clear example of the influence of religion and the provision of preferential treatment are the tax concessions available to religious organizations. For example, section 25(4) CITA 2004 LFN exempts from tax the income of charitable, religious, scientific or public educational institutions.

Some argue that the present tax dispensation is 'inequitable'; that it does not reflect present-day realities in the marketplace; that religious tax exemptions impose cost imposts on the public generally and, the benefits are for the purpose of advancing religion and the national interest. These sentiments are based on the premise that as Nigeria is a secular state, there is no need to advance any religion. This tension was also recognized in Australia by Kirby J (dissenting) in *FCT v World Investments* [2006] FCA 144,250, that;

“ A taxation exemption for religious institutions, so far as it applies, inevitably affords effective economic support from the Consolidated Revenue Fund to particular religious beliefs and activities of some individuals. This is effectively paid for by others... a cross-transference of economic support. The courts must recognize that this is deeply offensive to many non-believers, to people of different faiths and even to some people of different religious denominations who generally share the same faith”.

**Kirby J (supra) went on to emphasize the importance of equity between taxpayers that:**

“charitable and religious institutions should share with other taxpayers the liability to pay income tax upon their income. Exemptions needs to be clearly demonstrated as conformable to law”

Further, non-religious groups argue that section 10 of the 1999 Nigerian Constitution which provides that the Government of the Federation or of a State shall not adopt any religion as State religion was intended to make Nigeria a secular state and that reality ought to be reflected in denying preference to religion in tax exemptions privileges or business ventures .

The necessity for tax and regulatory reform to be binding and comprehensive in relation to Islamic finance in Nigeria was demonstrated in the South African High Court case of *Registrar of Banks v Islamic Bank of South Africa Ltd (in liquidation)* (Case No 25286/97) in October 1997. The regulator approved the granting of a banking license to the respondent based on shariah principles in the absence of appropriate banking and tax law. Further, the court – appointed inspector's Report in this case revealed serious misunderstanding and lack of consistency over tax treatment of so – called shariah compliant financing contracts.

Thus following the bank's collapse, the liquidator simply set aside the shariah construction of depositors' claims as well a clients debt obligations to the bank and applied conventional banking laws in the liquidation proceedings. This demonstrates the necessity for a comprehensive set of laws for regulatory authorities to apply in their governance duties and that religions tenets will not over ride the law. It is therefore necessary, proper and required that tax reforms be introduced to provide and regulate faith-based transactions ,particularly Islamic Finance.

A more interesting prospect would be the application of Islamic Criminal Law to the offence of tax evasion in the matter of Islamic Finance. The result of this application would of necessity be quite "handful". We may even begin to look forward to having Shariah Departments in the different Relevant Tax Authorities.

In the matter of banking and taxation in the name of God and the law in Nigeria, perhaps, in the words of Seneca-----

"Our fears are more numerous than our dangers and we suffer more in our imagination than in reality".

Finally, and in the mean time, we shall await the Relevant Tax Authorities to issue their information circular on the tax treatment of Islamic Financial Transactions in Nigeria.

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