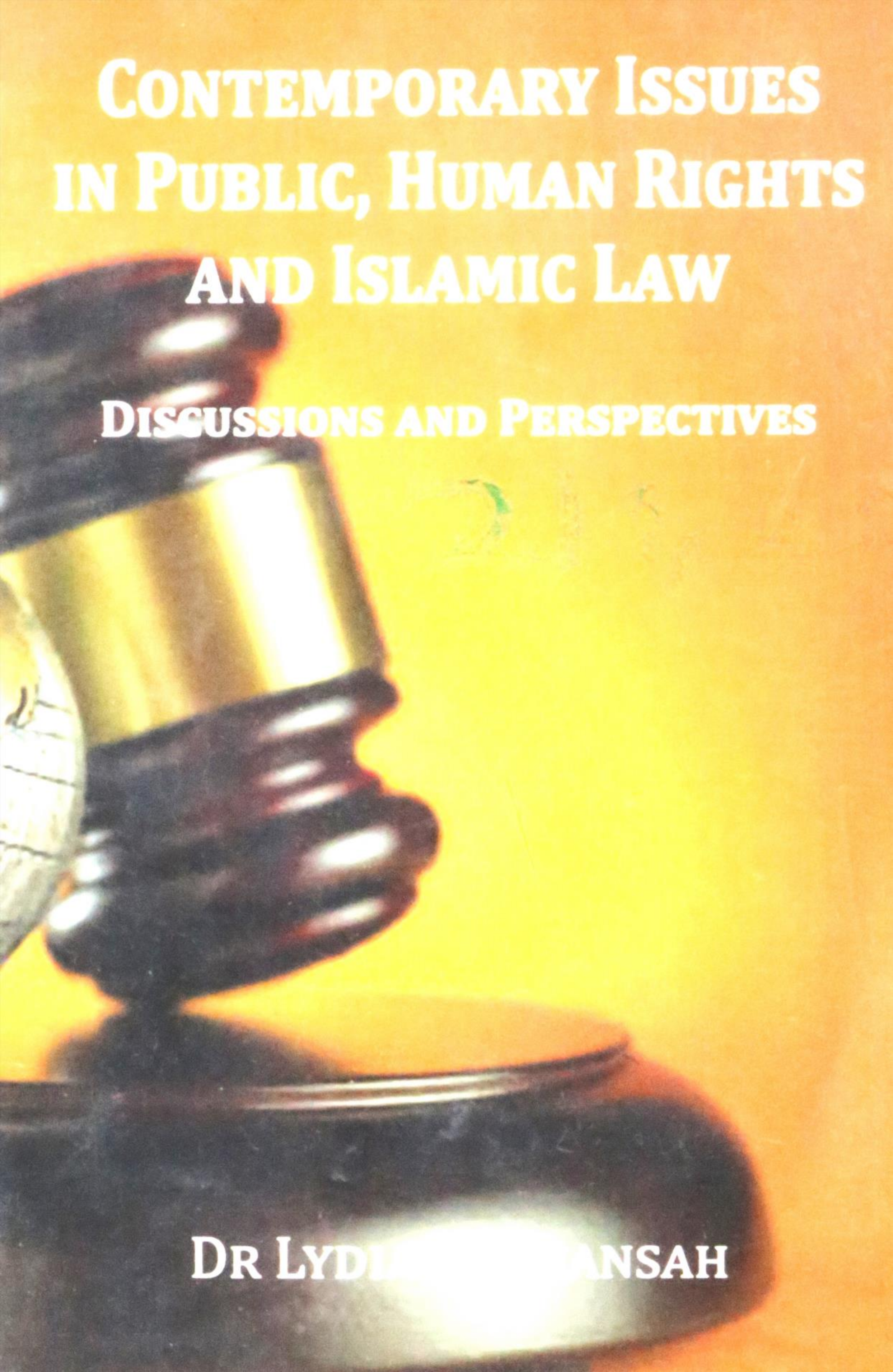




CONTEMPORARY ISSUES IN PUBLIC, HUMAN RIGHTS AND ISLAMIC LAW

DISCUSSIONS AND PERSPECTIVES

DR LYDIA A. ANSAH

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26. Appraising the Taxation Issues in *Ijarah* (Islamic Leasing)

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Summary of the Chapter

Due to the peculiar nature of Islamic finance as against conventional finance system, the application of the common law based Nigerian tax regulation on most of them seems always weeps up various clogs in the effort to tax them. Analysis and discussion of some of the issues in the taxation of Ijarah (Islamic leasing) an aspect of Islamic finance product constitute the main gist of this paper. The applicable sections of the Nigerian tax law that could be used to tax Ijarah are extracted; their content analysed in order to test the aptness of using them in taxing Ijarah. The paper in the final analysis recommends for the expansion of the regulatory regimes to accommodate Ijarah leasing, this according to the paper will aid the taxability of Ijarah under the Nigerian Tax Law.

Keywords: Taxation, Ijarah, Nigerian Law

1. Introduction

The increase in momentum as well as the wider acceptability of Islamic finance as a veritable alternative to the conventional finance system is an undisputable pointer to the viability of several aspect of Islamic finance mode globally, Nigeria inclusive. Countries of the world as well as most economic players and finance expert from the West now turned aggressively to the exploration of the benefit of non-interest finance system in energizing their economy.

Amongst the non-interest finance currently in practice in Nigeria are *Mudarabah* (Perceive partnership), *Murabahah* (Commercial founding with profit margin), *Musharakah* (Active partnership), *Ijarah* (Islamic leasing) etc¹⁴⁸⁴. In all these Islamic finance system, different tax issues may arise when using conventional tax law to tax them.

While some issues are fundamental because they may lead to an amendment of the law before such Islamic finance could be taxed using conventional tax law, some do not need any aggressive amendment, rather mere adaptation of policy from some other countries that are already practicing and taxing the product using a modified tax law based on their country's tax mode.

Ijarah just like other non-interest finance type, due to some dichotomy between the principles of the pure Islamic taxation as against the principles of common law which Nigerian tax law was built upon may attract some contradictions and or inconsistencies which may make its taxability impossible and a herculean task. Flowing from this, the tax regulatory authorities and administrators in Nigeria, the Federal Inland Revenue Service as well as some financial related institutions in Nigeria have in the past organized several workshops/conferences to see the possibility of designing a workable legal framework for the taxation of Islamic finance.¹⁴⁸⁵ Despite all these efforts, there are still some bottleneck in the taxation of Islamic finance products in Nigeria; *Ijarah* inclusive.

¹⁴⁸⁴ Tax issues in some of these finance system have been discussed by this author in some other papers. For instance, see Olokooba S.M. "Is *Musharakah* (limited partnership) taxable under the Nigerian Tax?" in Oyesola Anmashaun *et al* (ed.) *Changing Perspectives in the Law and Practice of Taxation in Nigeria: Essays in Honour of Prof. M.F. Abdulrazaq* (Kwara State University, Malete, 2017) pp 442-448.

¹⁴⁸⁵

Structured into six sections, the conceptual framework follows this section while the nature and characteristics of *Ijarah* is discussed in the third section. In section four, the mode of executing *Ijarah* as against the mode of executing conventional lease is appraised. Section five is the nucleus of the paper wherein the clogs in the taxation of *Ijarah* using the Nigerian conventional tax laws are examined. The paper ends in section six with conclusion and recommendations.

2. Conceptual Framework

Taxation power is not limited to the raising of revenue alone for the government purposes, a wide range of objectives, to wit: fiscal, social and economic may be achieved through "tax legislations"¹⁴⁸⁶. Specifically however, under Islamic taxation, the principle of equity, justice, fairness, welfarism and redistribution of wealth is the hallmark of taxation. According to Sabahuddin,¹⁴⁸⁷ Islamic taxation is generally for the achievement of certain specific social and economic ends with the general framework of Islam.

Literarily, *Ijarah* simply means Islamic leasing. *Ijarah* may also mean a consideration paid for hired services. *Ijarah* is given items or services on a rental basis for wages. Technically, according to Hussin and Hussin,¹⁴⁸⁸ *ijarah* is a sale of the use or benefit of another person's property. Flowing from this, *Ijarah* can be said to be service of an individual based on wages to be given as a consideration for hired services by the hirer to the hireree. This type of *Ijarah* according to Garba¹⁴⁸⁹ is known as *Ijaratul amal*. But if an *Ijarah* indicates the

¹⁴⁸⁶ As was held in *Osborne v Common Wealth* (1911) 12 CLR 321, see also Olokooba S.M. *Nigerian Taxation; Law, Practice and Procedures Simplified* (Singapore, Springer Nature Publisher, 2019) p. 137

¹⁴⁸⁷ Sabahuddin A. *Islamic Economics* (India, Goodword Books, 2004) p. 1-6

¹⁴⁸⁸ Hussin M.H and Hussin M.H, *Understanding Shariah and its Application in Islamic Finance* (IBFIM, Kuala Lumpur, 2011) as cited in Nabil Bello Said "Principles of Islamic Investment" in Shehu U.R. Aliyu, Nasir A. Ahmad, Bashir Tijjani and Munir Kamba (eds.) *Readings in Islamic Banking and Finance* (International Institute of Islamic banking and Finance, kano, 2013), p.134

¹⁴⁸⁹ Garba Bala Bello "Ijarah (Islamic leasing)" In Sulaiman Abdullahi Karawi *et al*, *Islamic Economics: A book of Reading* (The International Institute of Islamic thought (Nigeria office), Kano, 2012), p. 149

transfer of usufruct of a certain property to another individual in exchange for a rent claimed from him or her, then, such is called *Ijaratul ain*⁸⁰. *Ijaratul ain* is similar to conventional leasing in English.

Ijarah, if it is for hire purchase is known as *Ijarah thumma Bai*, which literally means lease of contract. Another category of *Ijarah* is *Ijarah Wal-iqtina*. This is an *Ijarah* contract that provides an asset to the client at an agreed rental price with a unilateral undertaking by the bank or the client that at the end of the lease period, the ownership of the lease asset would be transferred to the lessee⁸¹. Conventionally, a lease according to Hornby⁸² is a legal agreement that allows you to use a building a piece of equipment or some land for a period of time usually in return for rent.

An *Ijarah* that is based on hire contract usually involves the extraction of the usufruct benefit of a subject matter of transaction based on agreed wages. In *Ijarah*, unlike pure contract, ownership still resides in the incipient owner of the property. *Ijarah* in Arabic at times may mean *Aqdal-ijarah*. In this type of *Ijarah* only the right to use the object is transferred. In *Surat Al Talaaq*⁸³ Allah expressly made *Aqdal-ijarah* valid and legal when He commanded that wet nurse should be given their due for suckling babies. In the words of Allah, He said

I lodge them where ye dwell, according to your wealth, and harass them not so as to straighten life for them. And if they are with child, then spend for them till they give suck for you, give them their due payment and consult together in kindness, but if ye make difficulties for one another, then let some woman give suck for him.

In *Al-Qisas*⁸⁴ the story of Prophet Moses being hired by his father-in-law for certain period of time was narrated thus

⁸⁰ Ibid at p. 151, citing Lankar, A Brief about Business in Islamic Banking (Kuala Lumpur: Darul Ummah Publishers, 2011).

⁸¹ Sa'at, M.K. et al. *Islamic banking practices: From the practitioners perspective* (Kuala Lumpur), cited in Garba, *op cit* (n 6) p.153.

⁸² Hornby, A.S., *Oxford Advanced Learner's Dictionary International Student Edition* (7th Edition, Oxford University Press, 2004) p. 841.

⁸³ Surat Talaaq: 6.

“One of the two women said: o my father! Hire him! For the best (man) that thou can’t hire is the strong, the trustworthy “He said: lo! fain would marry thee to one of these two daughters of mine on a condition that thou hirest thyself to me for (the term of) eight pilgrimages. Then if thou completes ten it will be of thine own accord, for I would not make it hard for thee. Allah willing, thou will find me of the righteous.

Contract on hire is further sanction by the holy Prophet thus “Give a servant his fee before his sweat dries up” further Al Bokhari narrates a *hadith* which was cited in Al’Eddin¹⁴⁹⁴ and same was said to have been reported by Abu Hurairah in which the Prophet was quoted to have said, “Three persons are my adversaries on the day of judgment: A person who promised to give something in my name and cried off, and a person who sold a free man and took the price, and a person who hired a man, used his services and did not give him his due.” We should however note that some scholars never supported hire contract for they believed it is a contract on non-existent things. According to Ala ‘Eddin¹⁴⁹⁵ the benefits are not existing at the time of the conclusion of the contract; they accumulate gradually; and it is illegal to conduct a contract on a non-existent thing. Conceptually in this paper, *Ijarah* will be used as Islamic leasing, the lessee is “*mustajir*”, lessor is “*mujir*” and the rent payable to the lessor is “*ujrah*.”¹⁴⁹⁶

3. Mode of Executing *Ijarah*

Ijarah is a product leasing. It is a lease obligation where the owner of an asset based on a definite consideration agreed to transfers the accrued benefit to another party for an agreed period of time.

One important characteristics of an *Ijarah* contract is that, the leased asset remains in the ownership of the seller, and only its usage

¹⁴⁹⁴ Ala’Eddin Kharofa, *Transactions in Islamic Law* (A.S. Noordeen Kuala Lumpur, 2004) pp. 145-146

¹⁴⁹⁵ Ibid, p. 146

¹⁴⁹⁶ This usage is synonymous to their usage in Usmani M.T. *An introduction to Islamic Finance* (Part Two) (Lagos S.A AP-Aminu Publication, 1999) as cited in Garba, *op cit* (n.6), p. 149

is transfer to the lessee. In other words, in a lease, the incipient owner still possesses the ownership right while the lessee is only enjoying possessive right over the *res*. To actualise and ascertain the continued existence of the subject matter of lease, consumable items may not be an apt subject matter and or items, the reason being that, using such may affect the existence and functionality of such items due to diminishing. Thus, since the usage is still in the hand of the lessee, any liability that emerges from the used will naturally lie with him.

Further more, since both usage and period of usage must precede the completion of a lease, a lease asset cannot be used for other purpose or any other usage other than the agreed usage as well as period of time. For this, the lessee in law will be liable and the lessor is entitled to compensation for any wrongful use of the subject matter of lease. However, the lessee is protected and excluded from liability arising from an unforeseen deficient and or circumstances. In such a situation, the lessor shall bear the liabilities.

To determine the definite period of use in *Ijarah*, the date which the asset is delivered would serve as the commencement date of transaction. In the same vein, save an act caused by the lessee such as negligence or mishandling of lease property *etcetera*, any other serious damages to a leased asset naturally terminate the lease contract. Similarly unilateral increments of rent by the lessor without prior consent of the lessee also terminate the leasing act. This is so because, the rent fee must have been determined at the commencement of the whole lease period.

Actual delivery and taking possession is very important in Islamic leasing. This is clearly different from lease under the conventional practice. In conventional leasing, the lessor which most times are the financial institutions directly purchases the assets through the lessee, and, once the payment is made, whether the delivery has been effected or not the lease agreement and effective date of transaction commences. In Shariah compliant *Ijarah*, the commencement date is only when the delivery is effected. This is so, because until that is done, Islam views the payment of any money as interest *riba* which Allah abhors in the Quran thus:

“O you who believe eat not *ribah* (usury) double and multiplied but fear Allah that you may be successful”¹⁴⁹⁷

Similarly, According to Tanko¹⁴⁹⁸ *Ijarah* contract unlike the conventional contract of sale cannot be affected for future date. Thus, even though a forward sale is not allowed in Shariah compliant *Ijarah*, future date payment is allowed; but the actual commencement of contract is after the lease asset is delivered to the lessee. The main point of discussion here is that, Islamically, the actual delivery date marks the effectiveness as well as the commencement of *Ijarah* lease, because by that time, the res would have been ascertained in line with the cardinal principle of Islamic finance that forbid uncertainty-*gharar*.

According to Ahmad,¹⁴⁹⁹ Islamic finance rest on seven principles and these are distinctly listed in Obaidullah¹⁵⁰⁰ as follows

1. Freedom to contract as enshrined in Q2:275; 4:29
2. Freedom from *ribah* (interest) as enshrined in Q:30:39, 4:161, 3:130-2, 2:275
3. Avoidance of *Gharar* or excessive speculation and uncertainly
4. Freedom from *al-qimar* (gambling) and *al-maysir* (unearned income).
5. Avoidance of trading and investing in forbidden acts and objects (such) as gambling, pornography and alcohol.
6. Duality of risk (parties must share risk), and

¹⁴⁹⁷ Q3:130

¹⁴⁹⁸ Q 3:130

¹⁴⁹⁹ Ahmad B.D “Principles of Islamic Banking” in U.R-Shehu Aliyu etal (eds) *Readings in Islamic Banking and Finance* (Kano, International Institute of Islamic Banking and Finance, 2013)p. 61, see also Olokooba S.M “The Imbroglia on tax reforms to facilitate Islamic Finance in Nigeria. A contending but not contentions constitutional issue” *Journal Syariah Malaysia* vol. 25 (3) 2017, p. 5

¹⁵⁰⁰ Obaidullah M. *Islamic Finance Services* (King Abdul-Aziz University, 2006) pp. 10-12. See also, Brett F. and Mahmood N “The Constitution and Islam: Are Tax Reforms Possible to facilitate Islamic finance?” *Revenue Law Journal*, 20 Iss 1 Article 5, (2010). Also available at <http://epublications.bond.edu.au/rlj/vol20/iss1/53><assessed on 12/6/2015>

7. Asset-based financial transaction, based on the condition that identifiable and tangible underlying assets should underpin financial transaction.

Ijarah is the alternative to conventional leasing and in Islamic jurisprudence, *ijarah* is mostly used in two situations namely, *ijarat-ul-ain* and *ijarat-ul-amal*.¹⁵⁰¹ In practice, *ijarah* involves three parties: the Islamic Finance Institution IFI (lessee), the vendor and the customer (lessor). The customer will first indentify an asset or equipment to be leased. The bank will then purchase the asset from the vendor and lease it to the customer¹⁵⁰². The customer will then be paying by installment as agreed upon.

4. Taxation Issues in *Ijarah* leasing

Since the taxation of Islamic finance is constitutional¹⁵⁰³ taxing *Ijarah*, though may not be easy but same cannot be unconstitutional. However as shown in the case of *Mudarabah* (passive partnership) *Murabahah* (commercial funding with profit margin) and *Musharakah* (active partnership) there bound to be some distinct taxation issues and clogs that are likely to cropped up. The question now is what are those clogs as well as the tax issues that may likely occur if the Nigerian conventional based tax law is used to tax *ijarah* (Islamic leasing)? Is there any panacea to resolve those issues and clogs?

Amongst the legal issue that are likely to come up in the taxation of *Ijarah* with the use of Nigerian conventional tax law are, Stamp Duties Issue, Capital Gains Tax issue, Withholding Tax and Education Tax Issue. While some of these issues are not problematic in nature since there is no much effect in its application on the principles and tenets of Islamic finance, some others actually may affect the legality of

¹⁵⁰¹ Nabil bello said "Principles of Islamic Investment" in Shehu U.R. Aliyu, Nasir A. Ahmad, Bashir Tijjani and Munir Kamba (eds.) *Readings in Islamic Banking and Finance* (International Institute of Islamic banking and Finance, kano, 2013), p.134

¹⁵⁰² *ibid*

¹⁵⁰³ As argued by Olokooba, *op. cit* (n.16) pp 1-18

the application of the conventional law to Islamic finance product save some amendment and or reenactment of the tax law is carried out.

Issue of Stamp Duties

Basically, in *Ijarah* finance just like the conventional lease, the agreement charter used for such asset will define the rent and since this will normally involve couching of agreement, issue of Stamp Duties will surely arise. In *Ijarah* just as in conventional lease, agreement between parties will attract Stamp Duty. Specifically, section 69 (1) of SDA applies here; but no capital Gains Tax will be attracted in both cases. Similarly, another tax issues which is related to stamp Duties is if the *ijarah* is on hire purchase. In that situation, the lease will attract Stamp Duty as prescribed by section 5:30 SDA.

Issue of Withholding Tax

In *Ijarah*, it is the third party that will normally serve as the agent of payment and for that, issue of withholding tax will normally arise. Consequentially, in this case, the rental payment to the Islamic Finance Institution will also be subjected to withholding tax system as provided for in Section 79 of Companies Income Tax Act.

Issue of Capital Gains

The major dichotomy between *Ijarah* and Conventional lease is that, in the case of *Ijarah*, the rental payment is bifurcated into capital and profit only thus, any capital realized from operating lease of *Ijarah*, after its disposal at the end of the lease period will be subjected to Capital Gains Tax and same will be subjected to Section I (1) Capital Gains Tax Act. In the case of conventional lease however, the money involved will be treated as capital, profit and interest.

Issue of Income Tax

Similarly as provided in S. 9 CITA the profit element in *Ijarah* is income to Islamic Finance Institution and same is liable to CIT and

EDT which must be deducted by the Islamic Finance Institution. Similarly, as provided for in section 24 (a) CITA, the entire profit element in the *Ijarah* leasing is to be treated as deductible expenses to customer.

5. Conclusion and Recommendations

Despite series of similarities in the constituents of conventional lease and *Ijarah* (Islamic leasing), considering the peculiarities in the principle of Islamic taxation especially with relating to *ribah* (usury) or interest, which Islam forbids, the taxability of *Ijarah* using the Nigerian tax law still has some legal hurdles to scale especially on the tax implication of leasing which was omitted in the guideline released by the Federal Inland Revenue Services in 2010; this is a *lacunae* which need to be filled. To fill these *lacunae* the following is hereby recommended.

Recommendations

- **There is the need for the expansion of the content of guideline on taxation of lease in Nigeria:** The information circular No 2010/01 which was and still the guideline on tax implication of leasing should be expanded to include *Ijarah*. Doing this will aid the easy taxability of *Ijarah* under the Nigerian tax law.
- **Rental income also recommended to be treated as profit:** Since Islam abhors *ribah* (interest), and since the Islamic Finance Institution under the law is entitled to Capital Gains Allowance, it is hereby recommended that the capital portion of rental income and profit element in the *Ijarah* leasing at the hand of the Islamic Finance Institution be treated and equate with profit. Doing this will allow the third party (here the Islamic Finance Institution) to make gain in their interjected financial effort and such gain would never be perceive as *ribah* (usury).