

**TAXATION OF ISLAMIC FINANCE IN NIGERIA: THE  
INTEGRATION OF ISLAMIC TAX SYSTEM AND THE  
CHALLENGE OF ROBUST FRAMEWORK**

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**ABSTRACT**

Nigeria operates federal system of government whereby conventional system of financing is accommodated in its legislations as a result of British colonization. In the taxation of Islamic financial products, the disparity in principles that exist between the conventional financial system and Islamic financial system on the tax regimes as it relates to treatment of interest is a fundamental issue for tax purposes. This paper examined taxation of Islamic finance in Nigeria whereby looked at the integration of Islamic tax system and challenge of robust framework. The paper used doctrinal research method whereby primary and secondary sources of materials were examined for the study. The paper found that the existing framework for taxation of Islamic financial products in Nigeria is insufficient; and even the administrative body is not capable of proper administration of the Islamic tax system. Therefore, the paper recommends for a parallel legal framework for the taxation of Islamic financial institutions in Nigeria; and a different administrative body. The paper also recommends for scholarly view (fatwa) on the Zakat payment on monthly income of employees from public and private employment as obtainable in Malaysia.

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## KEYWORDS

Taxation, Islamic finance, Zakat, Robust framework, integration and scholarly fatwa

### 1.0 Introduction

Nigeria operates federal system of government whereby conventional system of financing is accommodated in its legislations as a result of British colonization.<sup>1</sup> In fact, the 1999 Constitution of Nigeria clearly states that the Government of the Federation or State shall not adopt any religion as a state religion.<sup>2</sup> The term Islamic finance refers to financial transactions that are consistent with the principles of Islamic law (Shari'ah).<sup>3</sup> The main principle of Islamic finance is that the payment and receipt of interest are forbidden.<sup>4</sup> Practices such as paying interest (Usury),<sup>5</sup> investing in business involved forbidden (haram) activities,<sup>6</sup> speculation or gambling (maisir),<sup>7</sup> uncertainty and risk (gharar)<sup>8</sup> etc. are all prohibited under Islamic finance. Also in taxation of Islamic financial products the disparity in principles that exist between the conventional financial system and Islamic financial system on the tax regimes as it relates to treatment of interest is a fundamental issue for tax purposes.<sup>9</sup> Islamic finance provides financing arrangement based on trading of assets, profit and loss sharing investments or leasing arrangements.<sup>10</sup> The disparity between the two systems of financing will automatically lead to tax anomalies; therefore, operating the two systems could raise a number of tax related issues.

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<sup>1</sup> Obilade, Akintunde Olusegun, *The Nigerian Legal System*, (Spectrum Books Limited Ibadan 1990) pp. 18-28

<sup>2</sup> Section 10 Constitution of the Federal Republic of Nigeria, 1999 as amended

<sup>3</sup> M Hurley, and D Brenna, Guidance Notes on the Tax Treatment of Islamic Financial Transactions, Corporate Business and International Division, Dublin Castle, Dublin

<sup>4</sup> Ibid, p. 3

<sup>5</sup> Qur'an 2: verse 275

<sup>6</sup> Qur'an 22: verse 41 & 78

<sup>7</sup> Qur'an 5: verse 90

<sup>8</sup> Qur'an 2: verse 188; Qur'an 4: verse 29

<sup>9</sup> MT Abdulrazaq, Are Islamic Financial Products Taxable in Nigeria?, Norlands Nigeria Professional Services, Nigeria, p. 2

<sup>10</sup> Discussion paper on the review of taxation treatment of Islamic finance in Australia, Oct., 2010 available online at <<http://www.ag.gov.au/cca>> last accessed on 3-11-2021 @ 2:15 pm

## **2.0 Tax Issues in Taxation of Islamic Financial Products**

One of such issues is the question whether the profit which accrues from an Islamic financial product is deductible in a similar manner to interest charged by a conventional financing.<sup>11</sup> Another issue of importance is the issue of double taxation usually levied on Islamic banks as a result of stamp duties and capital gains tax chargeable upon asset transfer; this is due to the fact that Islamic banks' financial intermediation is asset based.<sup>12</sup> Another issue is the issue of dual taxation on the Islamic financial institutions as it relates to obligation to pay corporate tax and Zakat at the same time which does imposed on the conventional financial institutions.<sup>13</sup> Or even individual tax as personal income tax and zakat on income which is obligatory.

Apart from the above tax issues, there are other issues of tax related which include the constitutionality of tax reforms to enable taxation of Islamic finance products; and tax treatment of transactions involving sharing of profit and loss under the tax regime. Another tax related issue is whether tax authorities could charge penalty or interest for any tax default by a non interest financial institution in view of the incompatibility of interest charging to the Islamic finance principles.

## **3.0 Legal Framework for Islamic Finance in Nigeria**

In Nigeria, the introduction of regulatory guidelines on non-interest financial services by the Central Bank of Nigeria<sup>14</sup> generated controversies because of the issue of secularism as contained in the Nigerian Constitution,<sup>15</sup> which states that the Government of the Federation or of a State shall not adopt any religion as State Religion.

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<sup>11</sup> KA Olatoye, Adjudicatory Issues and Constraints of Islamic (Non-Interest) Finance in Nigeria, LASU Journal of Social Sciences, vol. 11, June 2017, Free Enterprise Publishers, Lagos, pp. 125-141

<sup>12</sup> LS Sanusi, Islamic Finance in Nigeria: Issues and Challenges, Lecture delivered on 17<sup>th</sup> June, 2011, at Mark field Institute of Higher Education(MIHE), Leicester, UK, p. 20, available at < <http://eprc.sbu.ac.ir>> accessed on 14<sup>th</sup> January, 2022

<sup>13</sup> KA Olatoye, Regulatory Framework for Taxation of Islamic Finance Products in Nigeria, Chapter Six, Professorial Research Work, LASU, p. 254

<sup>14</sup> CBN Circular Reference No. FPR/DIR/CIR/GEN/01/010

<sup>15</sup> Section 10 Constitution of the Federal Republic of Nigeria, 1999 as amended

People like Eghes Eyieyen in his write up,<sup>16</sup> argued that the CBN Framework and Guideline on Non-Interest Financial Institution is illegal and unconstitutional because it conflicts with the legal definition of what NIFI means under the Banks and Other Financial Institutions Act (BOFIA), a law regulating banking activities in Nigeria. The definition of NIFI under the CBN Guideline means a bank that transacts investment or commercial banking business and maintains a profit and loss sharing account. He submits that this CBN framework by CBN defines a NIFI as a bank that has banking products modeled along sharia compliant principles. The use of the word 'sharia' under the framework is in violation of section 10 of the 1999 Constitution which prohibits the adoption of any religion as a state religion because Nigeria is a secular country. Similar views were shared by Egboro,<sup>17</sup> and Cardinal Olubumi Okogie.<sup>18</sup>

However, scholars have argued that the practice of Islamic finance in Nigeria is legal and constitutional. Abdul-qadir,<sup>19</sup> argued that Islamic banking practice is a religious duty for Muslims because Islamic law enjoins Muslims to engage in trade and to avoid usury.<sup>20</sup> He states that section 315 (4) (b) of the Nigerian Constitution can be used as the basis of legality of Islamic banking practice. This is because this section gives all laws made in Nigeria validity prior to the promulgation of the Constitution. On this, Islamic law is a law practiced by Muslims before the coming of the constitution and hence it is protected by this section. The author further argued that the same Nigerian constitution recognizes the freedom of thought and religion under section 38 which gives the Nigerian Muslims the right to establish banking system that

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<sup>16</sup> E Eyieyen, The CBN, Islamic Banking, the Law and Appropriate Regulation of Non-Interest Financial Institution in Nigeria, In: Adamu, K., 'Applicability of Islamic Project Finance Principles in Nigeria's Oil and Gas Sector, Bayero Journal of Islamic Law, maiden edition, vol. 1 Number 1, December, 2014, p. 43-44

<sup>17</sup> MK Kareem, Islamic Banking and the Question of Secularism in Nigeria, Ilorin Journal of Religious Studies, vol. 6, No. 1, 2016, pp. 77-99

<sup>18</sup> U Ahmed, et al., Islamic Banking and Finance in Nigeria: Exploration of its opportunities and challenges, available at <[www.emerald.com](http://www.emerald.com)> accessed on 20<sup>th</sup> August, 2023 @ 1:30PM

<sup>19</sup> A Abikan, Constitutionality of Islamic banking in Nigeria, In: Adamu, K., 'Applicability of Islamic Project Finance Principles in Nigeria's Oil and Gas Sector' Bayero Journal of Islamic Law, maiden edition, vol. 1 Number 1, December, 2014, p. 43-44

<sup>20</sup> Qur'an 2: verse 275

is in line with their religious belief. Similar views were submitted by Zubair A., and Alaro, A.A.<sup>21</sup>

In Nigeria, the practice of Islamic finance in Nigeria started sometimes in 1961 by the establishment of Muslim Bank West Africa Limited in Lagos but the bank was ordered to shut down by the Ministry of Finance.<sup>22</sup> This development was later founded by former Habib Bank, later Bank PHB and now Keystone Bank, upon the promulgation of Banks and Other Financial Institutions Decree in 1991.<sup>23</sup> Later on, the CBN issued framework to regulate Islamic finance in Nigeria by virtue of CBN Act which permitted for regulations on non-interest financial institutions.<sup>24</sup> Subsequently, license were issued to the Jaiz Bank Plc and Taj Bank Limited by the CBN to operate a full-fledged Islamic Banking System in Nigeria upon which followed several regulatory approvals.<sup>25</sup> Following the above, we discuss the legal framework for Islamic finance in Nigeria as follows:

### **3.1 Banks and Other Financial Institutions Act, 1991 Cap. B3, LFN, 2004**

This was originally a Military Decree but now deemed to be an Act of the National Assembly by virtue of the provision of the Nigerian Constitution as an existing law.<sup>26</sup> This law is the regulatory framework for banking business that supervise and regulate all banking activities in Nigeria, and also laid down a legal foundation for non-interest

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<sup>21</sup> A Zubair, and A Alaro, Legal and Operational Frameworks of Islamic windows in Conventional Financial Institutions in Nigeria, In: Adamu, K., Applicability of Islamic Project Finance Principles in Nigeria's Oil and Gas Sector, Bayero Journal of Islamic Law, maiden edition, vol. 1 Number 1, December, 2014, p. 43-44

<sup>22</sup> U Ahmed, et al., Islamic Banking and Finance in Nigeria: Exploration of its opportunities and challenges, available at < [www.emerald.com](http://www.emerald.com) > accessed on 20<sup>th</sup> August, 2023 @ 1:30PM

<sup>23</sup> AR Oshodi, Nigeria: Investigating Islamic Finance in Nigeria, 2014, available online at <<http://www.montaq.com>> accessed on 19/10/2019 @6:29am

<sup>24</sup> Section 33 (1) Central Bank of Nigeria Act, 2007 Act, N0.7; MT Abdulrazaq, Banking and Taxation in the Name of God and the Law, available at < [www.findpdf.net](http://www.findpdf.net) > accessed on 2-05-2019 @2:30pm

<sup>25</sup> K Adamu, Application of Islamic project Finance Principles in Nigeria's Oil and Gas Sector, Bayero Journal of Islamic Law, Vol.1Number 1, Maiden Education, December, 2014, P.41

<sup>26</sup> Section 315(1)(a) Constitution of the Federal Republic of Nigeria, 1999 as amended

banking business in Nigeria.<sup>27</sup> The Act started by defining the profit and loss sharing banks to mean a bank which transacts investment or commercial banking business and maintains profit and loss sharing account and for specialized bank to mean, among other things, such other banks as may be designated from time to time.<sup>28</sup> The Act states that every bank shall display at its offices its lending and deposit interest rates except the profit and loss sharing banks that are not liable on this section.<sup>29</sup> The CBN also has power to supervise and regulate the activities of other financial institutions and specialized bank as well as the power to prescribe their minimum paid up capital requirement for the purpose of operation.<sup>30</sup>

### **3.2 Central Bank of Nigeria Act, 2007**

This Act is enacted by the National Assembly in order to facilitate the achievement of economic management by ensuring monetary and price stability; issue legal tender currency in Nigeria; maintain external reserves to safeguard the international value of the legal tender currency; promote a sound financial system in Nigeria; and act as banker and provide economic and financial advice to the Federal Government.<sup>31</sup> The Act authorized the CBN to issue guidelines to any person and any institution under its supervision.<sup>32</sup>

### **3.3 Central Bank of Nigeria Regulation on the Scope of Banking Activities & Ancillary Matters, No. 3, 2010**

Pursuant to the powers vested in the Governor of the CBN to make regulations under section 57 of the Banks and Other Financial Institutions Act, the then Governor makes the above regulation.<sup>33</sup> The Regulation permitted certain banks to carry on business in Nigeria such as commercial banks, merchant banks, and specialized banks which include non-interest banks, microfinance banks, development banks

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<sup>27</sup> U Ahmed, et al., Islamic Banking and Finance in Nigeria: Exploration of its opportunities and challenges, available at < [www.emerald.com](http://www.emerald.com) > accessed on 20<sup>th</sup> August, 2023 @ 1:30PM

<sup>28</sup> Section 66 Banks and other Financial Institutions Act, 1991, Cap. B3, LFN, 2004

<sup>29</sup> Ibid, Section 23(1)

<sup>30</sup> Ibid, section 61(1a-b)

<sup>31</sup> Section 1(3) and 2 Central Bank of Nigeria Act, 2007, Act No. 7

<sup>32</sup> Ibid, section 33(1)(b)

<sup>33</sup> See Preamble of CBN Regulation on the Scope of Banking Activities & Ancillary Matters, No. 3, 2010

and mortgage banks.<sup>34</sup> Further, the Regulation stated that no bank in Nigeria shall be licensed to operate as a bank other than as one of the types specified above.<sup>35</sup> The Non-Interest banks may be authorized by the CBN to carry on banking business on a regional or national basis in accordance with rules, regulations, and guidelines on licensing, authorization, operation and conduct of business that the CBN may issue from time to time.<sup>36</sup>

### **3.4 Guidelines for the Regulation and Supervision of Institutions Offering Non-Interest Financial Services in Nigeria, issued 21<sup>st</sup> June, 2011**

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; sections 23(1), 52, 55(2), 59(1)(a), 61 of 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.<sup>37</sup>

This CBN guideline stated that the emphasis of the guideline is on Non-Interest Institutions operating under the principles of Islamic Commercial jurisprudence, one of the categories of Non-Interest Financial Institutions (NIFI).<sup>38</sup> The Guideline defines Non-Interest Financial Institution (NIFI) to mean a bank or other financial institution under the purview of the Central Bank of Nigeria, which transacts banking business, engages in trading, investment and commercial activities as well as the provision of financial products and services in accordance with any established non-interest banking principles.<sup>39</sup> The

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<sup>34</sup> Ibid, section 4(1a-c)

<sup>35</sup> Ibid, section 4(2)

<sup>36</sup> Ibid, section 4(4)

<sup>37</sup> See paragraph 3.0 Legal Framework, p. 4 of the CBN Guideline on CBN Circular Reference No. FPR/DIR/CIR/GEN/01/010 Guidelines for the Regulations and Supervision of Institutions offering Non-interest Financial Services in Nigeria, 21<sup>st</sup> June, 2011

<sup>38</sup> Ibid, See paragraph 4, page 1

<sup>39</sup> Ibid, paragraph 1, see page 2

guideline brings about two forms of Non-interest banking and finance models to wit: NIFIs based on principles of Islamic commercial jurisprudence; and NIFIs based on any other established rules and principles.<sup>40</sup>

#### **4.0 Legal Framework for Islamic Taxation**

Taxation establishes a social contract between ruler and citizens. The Qur'an confirms such position that the Ruler (Dhul Qar'nain) and the people living under threat of some invaders (Yajuj Wa Majuj) enter into a social contract whereby the Ruler will use his power to protect the citizens and in return to pay their dues.<sup>41</sup> The Qur'an clearly encourages spending from all of the benefits of good and halal human efforts, it states thus:

“O you who believed, spend from the good things which you have earned and from that which We have produced for you from the earth. And do not aim toward the defective therefrom, spending (from that) while you will not take it (yourself) except with closed eyes. And know that Allah is free of need and praiseworthy”<sup>42</sup>

Islamic sources of legislation on Islamic taxation are categorized based on primary and the secondary sources of Holy Qur'an, Hadith of the Holy Prophet, Ijma (Consensus of Jurists) and Qiyas (Analogical

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<sup>40</sup> Ibid, Paragraph 2, page 2

<sup>41</sup> Qur'an 18: verses 94 and 95

<sup>42</sup> Qur'an 2: verse 267



deduction). So many verses in the Qur'an prescribed the payment of taxes such as Zakat,<sup>43</sup> Khums,<sup>44</sup> Jizya<sup>45</sup> and Ushr.<sup>46</sup>

On the other hand, Islamic taxation was reported during the time of the Prophet in various Hadiths. The Hadith Narrated by Ibn- Abbas: the Prophet (S.A.W.) is reported to have sent Mu'az Ibn Jabal (R.A.) to Yemen and said:

“invite the people to testify that none has the right to be worshipped but Allah and I am Allah’s Messenger, and if they obey you to do so, then teach them that Allah has enjoined on them five prayers in every day and night, and if they obey you to do so, then teach them that Allah has made it obligatory for them to pay the Zakat from their property and it is to be taken from the wealthy among them and given to poor.”<sup>47</sup>

The Hadith of the Holy Prophet in Tirmidhi, which says, “*there are other claims too on the wealth of a person besides Zakat*” interpreted to be an authority to impose taxes in Islam.<sup>48</sup> Furthermore, it reported that the prophet appointed employees to collect, keep and distribute public funds. He appointed Ibn Rawahah and others to assess the quantities of produce from khaibar. He also appointed Umar Ibn Al-

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<sup>43</sup> Qur'an 2: Verse 110... “Establish regular prayer and pay Zakaat”, Qur'an 2: Verse 227 “Lo! Those who believe and do deeds of righteousness and establish regular prayer and pay zakaat, their reward is with their Lord and there shall no fear come upon them, neither shall they grieve.”, Qur'an 22: Verse 41 “And, (Muslims are) those who, if We establish them in the land (in authority) establish regular prayer and give zakaat, enjoin the right and forbid the wrong: with Allah rests the end of affairs”, Qur'an 22: Verse 78 “so establish worship, pay zakaat, and hold fast to Allah...” etc.

<sup>44</sup> Qur'an 8: Verse 41 “and know that whatever ye take as spoils of war, lo! a fifth thereof is for Allah, and for the messenger and for true kinsman and orphans and the needy and the wayfarer...”

<sup>45</sup> Qur'an 9: verse 29 “fight those who believe not in God and the last Day and (who) do not forbid what God and His messenger have forbidden such men as practice not the religion of truth, being of those who have been given the book, until they pay tribute out of hand and have been humbled”.

<sup>46</sup> Qur'an 4: verse 141 “... Eat ye of the fruit thereof when it Fruiteth, and pay the due thereof upon the harvest day, and be not prodigal. Lo! Allah loveth not the prodigals”.

<sup>47</sup> Sahih-ul Bukhari, Hadith No. 1395

<sup>48</sup> A Qadoos, and S Pakeeza, Imposition of Tax in Islam and Debate of Jurists in Historical Context, AL-ADWA 47:32 available at < <https://www.papers.ssrn.com> > accessed 29<sup>th</sup> September, 2019 @3:00pm

khattab and many others to collect zakat, and Abu Rafi and Bilal to take custody of public funds and to effect disbursements for public expenses.<sup>49</sup> Also, it was reported in Ibn Kathir that the prophet appointed state employees for the estimation and collection of kharaj, i.e. the share of land produce handed over to the government in return for using state-owned land that conquered by Muslim government.<sup>50</sup> It was also reported by Abdullahi Ibn Umar (R.A.) that the Prophet (S.A.W.) said: "I was directed to fight people until they testify that none is worthy of worship except Allah and Muhammad is the Messenger of Allah, they agree to pray *sallah* and pay Zakat."<sup>51</sup>

According to Al-Qardawi, in his book, says:

"if the proceeds of Kharaj, Ghanima and Fay' are sufficient, there is no need for imposing taxes, but if some sources do not exist or do not yield a sufficient amount, other taxes need to be levied, since the principle of Usul.<sup>52</sup> States, 'something without which an obligation cannot be fulfilled is also obligatory.'<sup>53</sup>

## **5.0 Constitutionality of Tax Reform to facilitate the Taxation of Islamic Finance in Nigeria**

One of the reasons in allowing for tax reform under the Nigerian Constitution is the need to ensure economic development for the economic well-being of the people. Chapter II of the Constitution confers a duty on the government to ensure improvement on the economic well-being of people;<sup>54</sup> even though this section is non-justiciable. Looking at this purpose, where a tax reform made to facilitate an alternative financing system like Islamic finance in order to ensure great contribution to economic development to the Nigerian nation thereby wipe out economic challenges and carried out in line

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<sup>49</sup> M Kahf, The early Islamic Public Revenues system: lessons and implications, p.25, available online at <<https://papers.ssrn.com/sol3/papers.cfm>> last accessed on 9/9/2019 @ 4:00pm

<sup>50</sup> Ibid p. 17-20

<sup>51</sup> Sahih Bukhari and Muslim reported, Hadith No. 8 in the Book of 40 Hadith.

<sup>52</sup> USUL refers to the science of FIQH methodology and axiomatic system

<sup>53</sup> NB Abu Bakar and A Abdul Rahman, A comparative Study of Zakah and modern Taxation, J. KAU: Islamic Econ., Vol.20 No.1, 2007, P.29

<sup>54</sup> Section 16 Constitution of the Federal Republic of Nigeria, 1999 as amended

with the constitutional provisions as stated above, then such reform is therefore said to be constitutional.<sup>55</sup>

Social consideration is another consideration for tax reform; to satisfy the yearnings of people in the society. This if linked to economic development consideration is the meeting of aspirations of substantial segment and yearnings of society in terms of creation of an environment that is conducive to the people's desire to avoid economic practices such as Ribah (interest) which are injurious to their Islamic beliefs. Such is the case with the large number of Muslims in Nigeria who had hitherto avoided taking Ribah or abandoned their rights to interests yielded on bank's account by simply allowing the bank to withhold same. According to the Scholars who raise a question thus: of what use to economic development are such withheld funds when particularly such accruals had never been formally channeled towards any public utility infrastructural development but rather channeled into private pockets.<sup>56</sup> Availing of the non-interest Islamic financial system to Nigerian society as it is done even in many Western countries will curb this anomaly and the consequence will be a flourishing national economy and peaceful co-existence.<sup>57</sup>

The arguments of secularism of Nigeria under provision of section 10 of the Constitution cannot withstand the economic and welfare development of the society considering the Nigerian government activities on religious yearly pilgrimage and the provisions of the Nigerian Tax Legislation. Under the tax legislations in Nigeria, Religious organizations are regarded as ecclesiastical bodies and their profits or gains' are tax exempts provided is not derived from trade or business.<sup>58</sup> So if the secularity status under section 10 of Constitution is not affected in respect of religious bodies by not only allowing for

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<sup>55</sup> MT Abdulrazaq, Banking and Taxation in the Name of God and the Law, Business Day, Newspaper, Thursday, 07 July, 2011; SM Olokooba, Taxation of Islamic Banking Products under the Nigerian Laws: Issues, problems and prospects, Bayero Journal of Islamic Law, Vol. 1 Number 1, Maiden Edition, Dec. 2014, P.4

<sup>56</sup> MT Abdulrazaq, Are Islamic Financial Products Taxable in Nigeria?, available online at <[www.findpdf.net](http://www.findpdf.net)> accessed on 10<sup>th</sup> May, 2021 @2:00pm; K Olatoye, Taxation of Islamic (Non-Interest) Banking and Finance Products in Nigeria, Chapter Five of Professorial research work, submitted to Faculty of Law, LASU

<sup>57</sup> Ibid, Olatoye, p. 310

<sup>58</sup> See sections 23(c) Companies Income Tax Act, Cap. C21 LFN, 2004 and section 19(1) paragraph 3, 3<sup>rd</sup> Schedule Personal Income Tax Act, Cap. P8 LFN, 2004

their establishment but accords them some tax exemptions, then the same line of reasoning in establishing Islamic financial institutions and carrying out tax reforms to accommodate same in order to get more sources of revenue for the government would not be affected by the secularity status and also it would be beneficial to the Nigerian government on the problem of dwindling sources of revenue of government.<sup>59</sup> Above all, freedom to practice religion is guaranteed as one of the fundamental right under the same Constitution of Nigeria;<sup>60</sup> therefore tax reform to accommodate the taxation of Islamic financial products is guaranteed to the Muslims faithful in Nigeria by the said provision of the Constitution.

In Nigeria, declaration of sources of income and payment of taxes is a constitutional obligation upon citizens<sup>61</sup> and the tax legislations made it explicit as a punishable offence to evade payment of taxes either by individual or corporate organizations.<sup>62</sup> Furthermore, all provisions of the tax legislations cited above for tax exemptions on profit or gain of religious bodies made it clear that such profit must not come from trade or business;<sup>63</sup> therefore since Islamic financial institutions engage in trade or business for gain or profit, then non- payment of tax might amount to non- observance of the constitutional obligation thereby committing an offence under the tax legislations.<sup>64</sup> However, the Islamic financial institutions would not have complied with the constitutional and statutory provisions without the tax reform to accommodate them under the tax legislations of Nigeria as carried out by other jurisdictions in the world like Malaysia.

The fact that taxation power is not limited to the raising of revenue alone; for government purposes, a wide range of objectives, such as fiscal, social and economic policies may be achieved through tax

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<sup>59</sup> MK Kareem, *Islamic Banking and The Question of Secularism in Nigeria*, Ilorin Journal of Religious Studies, Vol. 1, 2016, p. 87

<sup>60</sup> Section 38 Constitution of the Federal Republic of Nigeria, 1999 as amended

<sup>61</sup> Ibid, section 24(f)

<sup>62</sup> Part IV- Offences and Penalties, sections 40-49 Federal Inland Revenue Service (Establishment) Act, 2007

<sup>63</sup> See sections 23(c) Companies Income Tax Act, Cap. C21 LFN, 2004 and section 19(1) paragraph 3, 3<sup>rd</sup> Schedule Personal Income Tax Act, Cap. P8 LFN, 2004

<sup>64</sup> See PART VI, Federal Inland Revenue Service(Establishment) Act, 2007; PART XI, Personal Income Tax Act, (as amended by Act No. 20, 2011); and PART XIII, Companies Income Tax Act, No. 56, 2007

legislation.<sup>65</sup> Nigerian legislatures were empowered to make law under the constitution with respect to taxation of incomes, profits and capital gains;<sup>66</sup> therefore, there is nothing in the provision of section 10 of Constitution that invalidate the legislative power to tax pursuant to section 4(2) of the constitution for the tax reform to facilitate Islamic finance in Nigeria as rightly submitted by scholars.<sup>67</sup>

## **6.0 Integration of Tax on Non-Interest (Islamic) Financial Instruments in Nigeria**

In order to accommodate the evolving tax characteristics in the activities of Non-interest Financial System in Nigeria and the fact that there is no provision in the Nigeria tax regimes on the Non-interest Financial Services; Federal Inland Revenue Service came up with Regulations pursuant to its power under the Act.<sup>68</sup> The Regulation is for the taxation of Institutions offering Non-interest Financial Services in Nigeria.<sup>69</sup> The Regulation shall apply to all Non-interest Financial Institutions operating under the principles of Islamic Commercial Jurisprudence and Non-interest Banking and Finance on any other established non-interest principle.<sup>70</sup> For the purpose of taxation, the Regulation divided the Islamic finance services as follows:

**6.1 Home Finance:** This provides the Islamic Finance Services of Diminishing *Musharaka*, *Murabaha* and *Ijara*.

**A. Diminishing *Musharaka*:** This applies where a Financial Institution acquires a beneficial interest in a house from a vendor on behalf of a customer who also acquires a beneficial interest in the same house. The amount used to acquire the house is considered as a loan to the customer who shall pay back to the Financial Institution until final

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<sup>65</sup> RE Krever, and G Kewley, Australian Taxation: Principles and Practice, Cheshire: Longman Cheshire, 1987, p. 39

<sup>66</sup> See section 4(2) items 59 Exclusive Legislative list, Constitution of the Federal Republic of Nigeria, 1999 as amended

<sup>67</sup> K Olatoye, Taxation of Islamic (Non-Interest) Banking and Finance Products in Nigeria, Chapter Five of Professorial research work, submitted to Faculty of Law, LASU, p. 211; SM Olokooba, The Imbroglia on Tax Reforms to Facilitate Islamic Finance in Nigeria: A Contending but not Contentious Constitutional Issue, Shariah Journal, Vol. 25, No. 3 (2017), p. 518-520

<sup>68</sup> Section 61 Federal Inland Revenue Service (Establishment) Act 2007

<sup>69</sup> Non-Interest Finance Regulations No. 1, 2012

<sup>70</sup> Ibid, Section 2

payment. Each installment payment is made up of capital and rent paid to the Financial Institution.<sup>71</sup>

Taxation of the Transaction:

- i. The whole amount of the transaction is subjected to relevant taxes.
- ii. Any agreement executed between the Financial Institution and the vendor of a house shall be subject to Stamp Duties.
- iii. Proceeds of the transaction between the Financial Institution and the customer shall not be subject to Value Added Tax.<sup>72</sup>

**B. Murabaha:** This is an agreement whereby Financial Institution purchase a house for its customer from the vendor and resells it at a mark-up to the customer. The second purchase price which exceeds the first purchase price and the mark-up equates in substance to the return on investment of money at interest.<sup>73</sup>

Taxation of the Transaction:

(i) The First purchase price shall be subject to all relevant taxes since it is treated as the amount of a loan by the Financial Institution to the customer and the mark-up payable is treated as interest payable on the loan.

(ii) The second purchase price shall be exempted from Value Added Tax, Stamp Duties and Capital Gains Tax.<sup>74</sup>

**C. Ijarah:** this is an Islamic Finance lease whereby a lease agreement for the use of an asset with a definite rent. Under the Regulation, this arrangement is treated as a Finance Lease transaction under the Generally Accepted Accounting Principles as provided for in the FIRS Information Circular No. 2010/01- Guidelines on the Tax implications of leasing.<sup>75</sup>

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<sup>71</sup> Supra, Section 4, Part II of the Regulations

<sup>72</sup> Ibid, Section 4 (1) (f) (g) (i)

<sup>73</sup> Ibid, Section 5

<sup>74</sup> Ibid, Section 5(2)

<sup>75</sup> Ibid, Section 6(a)

Taxation of the Transaction:

- i. The Lease agreement executed between the Financial Institution and the vendor is subject to Stamp Duties.
- ii. Transaction for the purchase of a house shall be subject to Value Added Tax, Withholding Tax and Capital Gains Tax.
- iii. The final agreement executed between the Financial Institution and the customer at the end of the lease period shall be exempt from Stamp Duties and Capital Gains Tax.
- iv. A customer of the Financial Institution shall for the purpose of computing its income tax, treat the capital portion and mark-up as capital expenditure.<sup>76</sup>

**6.2 Project Finance:** This provides for Islamic Finance service of Murabaha, Musharakah, Mudarabah and Parallel Istisna.

**A. Murabaha:** This is a situation whereby the Financial Institution purchases an asset from a vendor and resells it at mark-up to its customer.<sup>77</sup>

Taxation of the Transaction:

(i) The first purchase price shall be subject to all relevant taxes since it is treated as of a loan made by the Financial Institution to the customer and the mark-up payable is treated as interest payable on the loan.

(ii) The second purchase price shall be exempted from Value Added Tax, Stamp Duties and Capital Gains Tax.<sup>78</sup>

**B. Mudarabah:** This is a situation where customer advances money to a Financial Institution as an agent with a view to producing profit from the said advanced money by the agent on a specified extent of profit to the customer resulting from use of the money. The Financial Institution is entitled to any additional profit resulted from the use of the money, which may include management fee paid by the customer. The

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<sup>76</sup> Ibid, Section 6 (b-e)

<sup>77</sup> Ibid Section 7(1)

<sup>78</sup> Ibid, Section 7(2) (a-d)

payment of customer's entitlement to profit is deemed to be return on an investment of money and interest.<sup>79</sup>

Taxation of the Transaction:

- i. The income earned from the arrangement shall be taxed as provided for under the Companies Tax Act (as amended) 2007
- ii. The payment made to the customer as a share of income shall be exempted from Withholding Tax.<sup>80</sup>

**C. Musharakah:** This is an arrangement where a Financial Institutions and the customer contributed an amount for the purchase of an asset whereby both acquires beneficial interest in the asset. The amount contributed by the Financial Institutions is treated as a loan to the customer from the Financial Institution which upon final payment the customer acquires the beneficial interest of the Financial Institution.<sup>81</sup>

Taxation of the Transaction:

- i. Each of the mark-up payment shall be subject to relevant taxes.
- ii. Any agreement executed between the Financial Institution and the vendor is subject to Stamp Duties.
- iii. Any agreement executed between the Financial Institution and the customer is not subject to Stamp Duties. The same principle applies to any proceeds between the Financial Institutions and the customer shall not be subject to Value Added Tax.<sup>82</sup>

**D. Parallel Istisna:** This is where the Financial Institution financed the execution of project for the Construction/Manufacture of a specific order, upon request by a customer and upon completion of the project

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<sup>79</sup> Ibid, Sec.8

<sup>80</sup> Ibid, Sec. 8(1) (f-g)

<sup>81</sup> Ibid, Section 9

<sup>82</sup> Ibid, Section 9 (1) (f-I)



by the contractor; the Financial Institution will transfer the project to the customer.<sup>83</sup>

Taxation of the Transaction:

- i. The transaction between the Financial Institution and the customer shall be exempt from Value Added Tax and Withholding Tax.
- ii. The transaction between the Financial Institution and the contractor of the project shall be subject to Value Added Tax and Withholding Tax.<sup>84</sup>

### **6.3 Commodity Finance and Vehicle Asset Finance:**

This provides for the Islamic finance services of Murabaha under commodity finance, Mudarabah under Vehicle Asset Finance, Ijara Vehicle Asset Finance and Diminishing Musharakah Vehicle Asset Finance.<sup>85</sup>

**A. Murabaha Under Commodity Finance:** This is an arrangement whereby Financial Institution purchase commodities/goods from the vendor and resells it at a mark-up to its customer. The second purchase price which exceeds the first purchase price and the mark-up equates in substance to the return on an investment of money at interest.<sup>86</sup>

Taxation of the Transaction:

(i) The first purchase price shall be subject to all relevant taxes since the amount is treated as the amount of a loan advanced by the Financial Institution to the customer and the mark-up payable is treated as interest on the loan.

(ii) The second purchase price shall be exempted from Value Added Tax, Stamp Duties and Capital Gains Tax.<sup>87</sup>

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<sup>83</sup> Ibid, Section 10

<sup>84</sup> Ibid, Section 10 (d-e)

<sup>85</sup> Ibid, Part IV of the Regulation

<sup>86</sup> Ibid, Section 11(1)

<sup>87</sup> Ibid, Section 11(2) (a-d)

**B. Murabaha under Vehicle Asset Finance:** This is an arrangement whereby Financial Institution purchase a vehicle from a vendor and resells it at a mark-up to its customer. The second purchase price which exceeds the first purchase price and the mark-up equates in substance to the return on an investment of money at interest.<sup>88</sup>

Taxation of the Transaction:

(i) The first purchase price shall be subject to all relevant taxes since the amount is treated as a loan advances by the Financial Institution to the customer and the mark-up is treated as interest payable on the loan.

(ii) The second purchase price shall be exempted from Value Added Tax, Stamp Duties and Capital Gains Tax.<sup>89</sup>

**C. Ijara under Vehicle Asset Finance:** This is an Islamic Finance whereby a lease agreement for the use of an asset with a definite rent. Under the Regulation, this arrangement is treated as a finance lease transaction under the Generally Accepted Accounting Principles and as provided for in the FIRS Information Circular No. 2010/01-Guidelines on the tax Implications of leasing.<sup>90</sup>

Taxation of the Transaction:

- i. Any lease agreement for the purchase of vehicle between the Financial Institution and a vendor shall be subject to Stamp Duties.
- ii. Any transaction for the purchase of a vehicle between a Financial Institution and a vendor shall be subject to Value Added Tax and Capital Gains Tax.
- iii. The agreement executed between the Financial Institution and the customer at the end of the lease period for a nominal value shall be exempted from Stamp Duties and Capital Gains Tax.
- iv. For the purpose of computation of income tax, a customer under this arrangement shall treat the capital portion and mark-up as capital expenditure.<sup>91</sup>

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<sup>88</sup> Ibid, Section 12(1)

<sup>89</sup> Ibid, Section 12(2) (f-I)

<sup>90</sup> Ibid, Section 13

<sup>91</sup> Ibid, Section 13 (a-e)

**D. Diminishing Musharakah under Vehicle Asset Finance:** This is a situation where Financial Institution acquires beneficial interest in a vehicle purchase from a vendor jointly with a customer. The amount contributed by the Financial Institution is treated as a loan to the customer who upon completion of payment to the Financial Institution's beneficial interest will acquire complete ownership.<sup>92</sup>

Taxation of the Transaction:

- i. Upon each installment payment of capital and mark-up to the Financial Institution shall be subject to relevant taxes.
- ii. Any agreement executed between the Financial Institution and the vendor of a vehicle shall be subject to Stamp Duties.
- iii. Agreement for transfer of ownership between the Financial Institution and the customer shall not be subject to Stamp Duties.
- iv. The transaction between the Financial Institution and the customer shall be subject to Value Added Tax.<sup>93</sup>

**6.4 Direct Investment:** This provides for the Islamic finance service of Mudarabah and Musharakah.<sup>94</sup>

**A, Mudarabah:** This is a situation whereby a customer appoints Financial Institution as an agent and provides money for the Financial Institution with a view to producing profit. The customer is entitled to specified profit resulting from the use of the money while the Financial Institution entitle to any additional profit it may also be entitled to management fee paid by the customer. Payment made to the customer as profit shall be deemed in substance as return on an investment of money and interest.<sup>95</sup>

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<sup>92</sup> Ibid, Section 14

<sup>93</sup> Ibid, Section 14 (f-I)

<sup>94</sup> Ibid, Part V of the Regulation

<sup>95</sup> Ibid, Section 15(1)

Taxation of the Transaction:

- (i) The income earned from the transaction shall be taxed as provided for under the Companies Income Tax Act (as amended) 2007.
- (ii) Payment made to the customer as a share of income by the Financial Institution shall be exempt from Withholding Tax.<sup>96</sup>

**B. Musharakah:** This is a situation whereby Financial Institution acquires a beneficial interest in an asset from a vendor jointly contributed with a customer who in return pays back the beneficial interest of the Financial Institution with a mark-up in order to acquire the complete ownership of the asset.<sup>97</sup>

Taxation of the Transaction

- i. The mark-up paid to the Financial Institution shall be subject to relevant taxes.
- ii. Agreement executed between the Financial Institution and the vendor is subject to Stamp Duties.
- iii. Agreement executed between the Financial Institution and the customer shall not be subject to Stamp Duties.
- iv. The transaction between the Financial Institution and the customer shall be subject to Value Added Tax.<sup>98</sup>

**6.5 Investment Bond:** This provides for the Islamic financial services of Sukuk and financial products under Sukuk.<sup>99</sup>

**A. Sukuk:** This is a situation where a Financial Institution agrees to pay a sum of money to a customer upon identification of an assets or class of an asset which the customer will acquire for the purpose of generating income or gains on a specified period for the existence of the asset. The customer will undertake to dispose the asset at the end of the Bond term, to repay the capital during or at the end of the Bond

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<sup>96</sup> Ibid, Section 15(1) (f-g)

<sup>97</sup> Ibid, Section 16(1)

<sup>98</sup> Ibid, Section 16(1) (F-I)

<sup>99</sup> Ibid, Part IV of the Regulation

term, to pay additional amounts and to arrange for the management of the Bond assets.<sup>100</sup>

Taxation of the Transaction:

- i. The gains under this arrangement are treated as interest accruing and subject to the provisions of the Companies Income Tax Act.
- ii. Sukuk shall be treated as bonds for the purpose of tax.<sup>101</sup>

## **7.0 Challenge of robust framework for Islamic Taxation in Nigeria**

The fact that Islamic financial system is different from the conventional system and in order to accommodate the taxability of income under Islamic financial transaction, the Nigerian government came up with regulation in line with Shariah principles.<sup>102</sup> Therefore, for tax purposes profits derived from Islamic financial transactions is given the same treatment as interest in conventional financial transactions. Thus, equal treatment with respect to withholding taxes, exemptions and deductions also apply.<sup>103</sup> However, this position is being criticized by Islamic scholars and advised countries to avoid using interest as benchmark in the tax statutes so as to avoid giving the impression of any semblance of interest in Islamic financial transactions and ended up in involving into prohibited transaction with interest.<sup>104</sup> The challenge of the lack of legal framework for Islamic taxation in Nigeria is an enormous one because the only Regulation for the taxation of Islamic financial transactions equated in substance to interest so as to subject the transaction to tax in order to fulfil the requirement of tax neutrality.<sup>105</sup> For instance, in Murabahah arrangement where in order

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<sup>100</sup> Ibid, Section 17

<sup>101</sup> Ibid, Section 17(1) (g-h)

<sup>102</sup> Section 2 Non-Interest Finance Regulations No. 1, 2012 of Nigeria

<sup>103</sup> N Arzim, Malaysia: the Tax Haven for Islamic Finance, available online at <[www.arzim.blogspot.com/2011/02](http://www.arzim.blogspot.com/2011/02)> last accessed on 5th January, 2020 @2:30pm

<sup>104</sup> KA Olatoye, Taxation OF Islamic (Non-Interest) Banking and Finance Products in Nigeria, International Journal of Innovation Research and Advanced Studies, Vol. 4, Issue 12, December, 2017, P.360

<sup>105</sup> The Principles of tax neutrality stipulates that tax policies should not vary between different types of enterprises; MT Abdulrazaq, Principles of Nigerian Tax

to subject the transaction to tax, it was equated in substance to interest.<sup>106</sup> Another challenge of the Regulation for taxation of Islamic Financial Services in Nigeria is that it has not comprehensively provide for some essential Islamic finances such as Bait ul-salam; Takaful; Manfa'a; Wakala financial products, and subject them to appropriate taxes to avoid violation of principle of Shariah.<sup>107</sup> So there is serious challenge on the framework for taxation of Islamic financial transactions in Nigeria due to lack of robust framework for Islamic tax system.

## **8.0 Conclusion and Recommendation**

8.1 It is observed that Nigeria has serious challenge on the Islamic tax regulatory framework for the taxation of the Islamic financial transactions and other Islamic taxes.

8.2 It is also observed that the only law or regulatory instrument for the taxation of Islamic financial transactions in Nigeria is the Regulation for taxation of institutions offering Non-Interest financial services made by the Board of Federal Inland Revenue Service pursuant to section 61 of the Federal Inland Revenue Service (Establishment) Act, 2007

8.3 It is also observed that apart from the Federal Inland Revenue Service that was giving the mandate to regulate and administer the taxation of Islamic financial institutions in Nigeria, there is no any government body handling the regulation and administration of the Islamic tax.

8.4 It is observed that there are several tax potentials in the taxation of Islamic financial transactions and other Islamic taxes which might seriously increase sources of internally generated revenue of government particularly with the dwindling sources of government revenue.

8.5. Following the above observations, the paper hereby recommends as follows:

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Planning and Management, Sterling-Horden Publishers Ltd., Oyo, second edition, 2013, p. 45

<sup>106</sup> See Parts II, III, and IV Non-Interest Finance Regulations No. 1, 2012

<sup>107</sup> Qur'an 2: verse 275

8.5.1 That there is need for a comprehensive legal framework for taxation of Islamic financial transactions in Nigeria that will provide a parallel legislation and/or regulatory instruments to deal with the Islamic peculiarities of all the Islamic financial instruments for tax purposes.

8.5.2. That there should be a government administrative body that will be giving the mandate to regulate, administer, collect and account for the taxation of the Islamic financial transactions and other Islamic taxes in Nigeria different from the FIRS who are tax collectors on behalf of Federal Government collecting taxes from the conventional financial institutions.

8.5.3. That there should be serious scholarly view (fatwa) on Zakat payment on the income in monthly basis and possible implementation by the employers upon the agreement of the employee in private or public organizations in order to increase compliance on the payment of Zakat tax just like what is obtainable in Malaysia.

In conclusion, the taxation of Islamic financial institution is one of the viable means of increasing sources of revenue for government in Nigeria particularly with the dwindling sources of revenue of government but because of the absence of robust legal framework that will look at the nature of the peculiarity of the Islamic financial instruments and come up with a parallel legislation for tax purposes. Therefore, the taxation of Islamic financial instruments requires not a mere Regulation or general amendment into the existing tax legislations just like what is obtainable in Malaysia but a special framework to address the peculiarity of each and every Islamic financial instrument for tax purposes.