

Impact of Indirect Tax on Exacerbating Poverty in Pakistan; An Analysis from Shari'ah Perspective

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Abstract

The regressive nature of indirect taxation in Pakistan elevates poverty and poses a significant challenge to its reduction efforts. These types of taxes, levied on consumption of goods and services, disproportionality affect low-income households, who spend a large portion of their income on essential commodities. As a result, indirect taxes erode disposable income, limit excess to necessities and become a cause of exacerbating poverty and widening income inequality. The first objective of this paper is to examine the effect of indirect tax on exacerbating poverty. The second objective is to discuss Shari'ah legitimacy of taxes and examine the Shari'ah appraisal of Indirect Taxes. In addition to these, we also discuss how indirect taxes disproportionately affect the impoverished and result in more poverty. In order to gain the first objective, empirical approach was adopted with descriptive analysis. Graphical presentation was used to elaborate on the results of the quantitative data. For the second objective, critical analysis of literature review techniques and descriptive statistics were used to elaborate the results. The finding of this study provides compelling evidence of a significant positive correlation between indirect taxes and poverty levels. Our analysis demonstrates that an increase of indirect tax burden exerts a substantial negative impact on livelihood, which results in exacerbating poverty. The increase in poverty is also a cause of socio-economic disparities. The findings underscore the urgent need of comprehensive tax reforms. The effective tax reforms, particularly a well-designed decrease in indirect tax, can significantly affect poverty. The reduction in taxes may lead to better access to necessities which may result in

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improving the living standards of the poor community. This research recommends an analysis of Pakistan's indirect tax system through the lens of Shari'ah calls for reforms that align with the principles of justice, equality and well-being of the deprived community. Simultaneously, Shari'ah compliant reforms would advocate for strengthening direct taxation on wealth and income, ensuring that the affluent contribute to the society. It also fosters a system where the tax burden is shared according to the ability and financial position of the people.

Keywords: Indirect tax, Poverty, Shari'ah, Direct tax, income inequality, Equal distribution of wealth

1. Introduction

A good tax system is essential for the management and administration of any country and for developing its infrastructure (Bird, 2010). This is an involuntarily payment that is implemented by the state or its related agencies, provinces, and municipalities without anyone's consent (Khalid & Nasir 2020). Without taxes, it is not possible to bear the expenses incurred in running the country's affairs (Nwakanma & Nnamdi, 2013). Otherwise, the country becomes weak both internally and externally and then it needs to borrow from international financial institutions to run its economic affairs, which becomes a means of imposing more taxes on the nation. In addition, trillions of rupees have to be paid in interest on the borrowed loans. The scope of the negative effects of external debt is not only economic but also political. The lending institutions try to run the political, social and economic systems of that country according to their dictates (Bird & Rowlands, 2001). They influence the formation of the country's internal and external policies, laws and even the constitution (Breen, 2013). Resultantly, the security and sovereignty of any country depends on a well-organized and functional taxation system.

This study discusses the indirect taxes in the perspective of Shari'ah and their impact on exacerbating poverty in Pakistan. Indirect taxes in Pakistan often exacerbate poverty due to their regressive nature, disproportionately affecting low-income people who spend a major portion of their income on essential goods (Alvi et al., 2024). This contradicts with the Shari'ah principles which emphasize social justice, equal distribution of wealth and ethics.

As Quran says, “Allah does not burden anyone, except something within its capacity”¹

Shari’ah advocates for a system where the tax burden is commensurate with the ability to pay, safeguarding the vulnerable from economic hardship. The reliance on indirect taxes in Pakistan creates a scenario where the poor are further impoverished, hindering their ability to meet the necessities of life (Razzaque, Islam, Rehman & Ali, 2024). Therefore, reforms are required to align fiscal policies with the Shari’ah guidelines.

The research questions of this study contain: what is the impact of indirect taxes on poverty in developing countries; and how these taxes affect valuable population? It further explores what is the Shari’ah legitimacy of taxation in the community and whether different forms of taxation, beyond traditional Zakat, are permissible within Islamic jurisprudence. This involves analyzing religious text and scholarly interpretation to determine the conditions under which a Muslim state can impose taxes. As poverty in the developing Muslim counties is increasing day by day while more taxes are being imposed which are enhancing the inferior positioning in Muslim community. This study seeks to bridge the gap between economic policies and religious principles, providing insight into tax structures that are both effective in poverty reduction and compliant with Islamic jurisprudence.

As far as poverty situation is concerned, poverty is one of the fundamental challenges in the field of economics. Poverty is a pervasive issue that not only affects the society and nation but the entire global community (Cobbinah et al., 2013; Andreou, 2021). This complex problem stems from multiple factors like corruption, theft, unequal distribution of wealth and various forms of injustice. Poverty manifests when individuals or groups remain deprived of the basic resources required to maintain a minimum standard of wellbeing. Poverty has two categories absolute poverty and relative poverty (Aslam, 2014; Zubair & Hayyat, 2020). Absolute poverty refers to a situation when individuals lack the financial resources of most basic needs for survival like food, shelter and clothes. Relative poverty, on the other hand, accrues when individuals or groups have less income as compared to others within society (Wolff, 2020). Shari’ah provides

¹ Al Baqra, Para 2, Ayaah 286 – Kanzool Iman

comprehensive guidelines for addressing poverty and promoting equal distribution of wealth along with preventive measures that reduce poverty. As preventive measures, the government needs to find and address all those causes which exacerbate poverty in the society including unjustified taxes. As indirect tax related to the consumption of products and services. Therefore, every citizen whether he/she is rich or under absolute poverty, must pay this tax. The main objective of this paper is to see the impact of indirect tax on poverty in addition to investigating the Shari'ah appraisal of indirect taxes which are imposed on all the community without segregation of the poor and the rich. Furthermore, we shall also discuss how indirect tax directly hits the poor and causes more poverty in the society. This paper is qualitative in nature to investigate Shari'ah appraisals of taxes however, secondary data was used to investigate the impact of indirect taxes on poverty.

2. Literature Review

2.1 Taxation System in Pakistan

The taxation arrangement of Pakistan comprises of taxes on different sources of income, consumption, wealth, profits and capital gains. It also makes use of custom duties, excise duties, levies and surcharge for revenue collections. The first sources of information through which we can draw a line between federal and provincial or direct and indirect taxes is constitution of Pakistan (Zafar, 2017). In order to achieve the objective of this paper, two main types of taxes, direct taxes and indirect taxes are relevant to our topic. By definition, direct tax is that which is levied on any institution or individual on the income they earn while indirect taxes are relevant to consumption of goods and services (Munir & Sultan, 2018). The Constitution of Pakistan 1973 contains a complete description of direct taxes for the federal government, including income tax, corporation tax, property tax and wealth tax. While at the provincial level, there are land revenue, immovable property tax, tax on transfer of property, agricultural income tax, capital gains tax and tax on professions. Trades and callings are also included in direct taxes².

In contrast, indirect taxes are those which are imposed and levied on the consumption of goods and services. Therefore, these taxes have no relation to the income of a person or organization nor to its financial status. It is applied to all individuals and organizations at the same rate. Therefore, whoever becomes a

² Constitution of Pakistan 1973, Annexure II, Federal Legislative List and Cun-current List

buyer of an item, this tax will be applied to him irrespective of the fact that he is a poor person or a landlord. These taxes include sales tax, excise duty, import tax, export tax, gas and petroleum surcharge, foreign travel tax, stamp duty, sales tax on services, motor vehicle tax, entertainment tax, excise, cotton fee and electricity duty. So, it can be said that the tax that reaches the state treasury without any intermediary is direct and the tax that reaches its treasury indirectly, i.e. through a trader or institution, is indirect tax. It should be noted that although all forms of taxes differ in their nature and rate, they all fall under the same two categories of direct or indirect taxes.

As far as direct taxes is concerned, they are not applied indiscriminately to the rich and poor, but are imposed on people with incomes above a certain limit. So, as income increases, its rate also increases. The only debate on the rate of direct taxes is whether the prevailing rate of tax is low or high. Is the prevailing rate of tax unfairly burdening the income of the people etc.? Tax slabs of the current year 2024-25 for individuals and associations is given according to FBR circular No 01, 2024-25 dated 19 July 2024.

2. Tax rates on taxable income for individuals and association of persons

The rates of tax imposed on taxable income of individuals and associations of persons [AOPs] have been changed through the Finance Act, 2024. The rates of tax for individuals and AOPs except a salaried individual are as under: -

S#	Taxable Income	Rate of Tax
(1)	(2)	(3)
1.	Where taxable income does not exceed Rs. 600,000/-	0%
2.	Where taxable income exceeds Rs. 600,000 but does not exceed Rs. 1,200,000	15% of the amount exceeding Rs. 600,000
3.	Where taxable income exceeds Rs. 1,200,000 but does not exceed Rs. 1,600,000	Rs. 90,000 + 20% of the amount exceeding Rs. 1,200,000
4.	Where taxable income exceeds Rs. 1,600,000 but does not exceed Rs. 3,200,000	Rs. 170,000 + 30% of the amount exceeding Rs. 1,600,000
5.	Where taxable income exceeds Rs. 3,200,000 but does not exceed Rs. 5,600,000	Rs. 650,000 + 40% of the amount exceeding Rs. 3,200,000
6.	Where taxable income exceeds Rs. 5,600,000	Rs. 1,610,000 + 45% of the amount exceeding Rs. 5,600,000

Federal Board of Revenue- 2024

Since direct taxes are levied on individuals with incomes above a certain threshold, they not only protect the poor and low-income earners, but also implement the principles of wealth circulation and fair distribution of wealth to

a large extent. But to achieve this goal, it is very important that the tax revenue must be used with trust and responsibility, and that its total amount must be spent on public welfare and national development instead of being spent on unnecessary government luxuries and on non-productive activities.

But in case of indirect taxes, Shari’ah does not encourage it at all, because in its presence, the concept of social and economic justice and welfare disappears. This tax is imposed on every person and institution without distinction. Even mosques and welfare institutions are not exempted from the burden of this tax. Therefore, the burden of indirect taxes ultimately falls on the consumers, the majority of whom are poor. For example, a person whose salary is PKR. 500,000 and another person who earns only PKR. 37,000 per month (minimum salary as per government accouchement), when both of them go to the market to buy groceries and other household accessories, both will pay GST i.e. General Sales Tax at the same rate. Even a person who has received a few thousand rupees as Zakat from somewhere will also be liable to pay indirect tax at the same rate at the time of purchaSse with his Zakat money. What could be more ridiculous than this?

We have collected data from the FBR for the period 2011 to 2024 and observed that tax collection is increasing with time³. The details of the tax collection are given below:

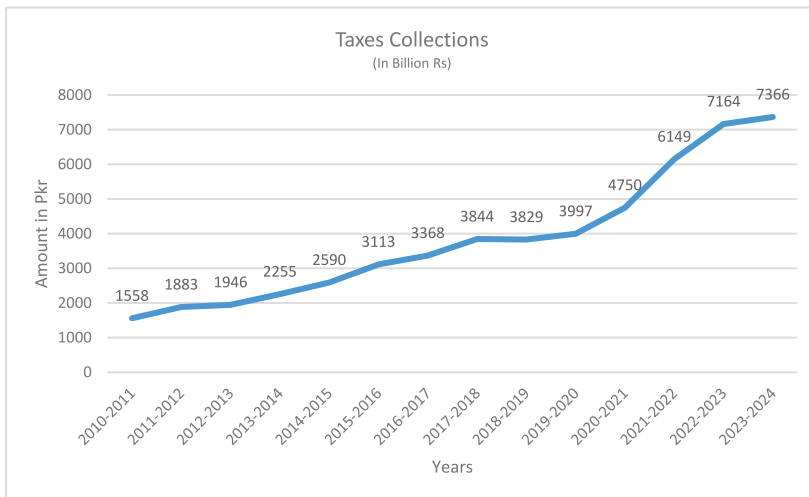


Figure 2.1 Poverty Situation in Pakistan

³ <https://download1.fbr.gov.pk/Docs/201215151230514Final%20Yearbook>

According to the latest report of the World Bank issued in October 2024, the poverty rate in Pakistan has increased to 40.5 percent, while this rate was 40.2 percent in 2023, meaning that the poverty rate has increased instead of decreasing compared to the previous year. This also makes a fuss to the claim of the current rulers, under which they are seen announcing that the poverty is decreasing after their coming to power. According to this report, 97.2 million people out of Pakistan's 240 million population are poor and 13 million more people have joined the list of poor in 2024 compared to the previous year⁴. A brief picture of the poverty rate is also described in the chart below:

As per World Bank standards, a person earning one and a half dollars, or 417 rupees per day (assuming that the one dollar is equal to 278 PKR), is considered below the poverty line. What a heartbreaking report that in this era of inflation, when chicken meat's cost is more than seven hundred rupees per kilogram, how can a person survive on four hundred and seventeen rupees? However, international standardized poverty lines used for global comparisons are \$2.15, \$3.65, and \$6.85 per day (in 2017) according to the World Bank. These lines represent the typical national poverty lines of low-income, lower-middle-income, and upper-middle-income countries, respectively⁵.

2.2 Empirical Evidence

A study was conducted by Alvi, Audi & Ashiq (2024) to find out the relationship between indirect tax and poverty by using secondary data. Empirical approach was adopted to find out the results. They found that indirect tax does not significantly impact on poverty, however, they suggested a review of the tax structure to ensure it does not burden low-income households. A progressive tax system could aid in wealth redistribution and support poverty reduction efforts.

A study was conducted in Turkiya by Karanfil & Ozkaya (2013) that shed light on the empirical relationship between indirect tax, social expenditure and poverty over the secondary data of 30 years. They used cointegration analysis to investigate the relationship between headcount index and the share of indirect tax in the total tax income. The study concluded that the portion of poor population increased with the impact of indirect taxes. They added that for the long run poverty reduction program, tax reforms are necessary.

An article was published by Voto (2019) where he investigated the effect of direct

⁴ World Bank Group, Pakistan Development Update, October-2024, p:7

and indirect taxes on poverty in developing countries. In this paper, annualized penal data of 37 developing countries for the period of 1995-2016 was used. Empirical approach was adopted to find out the results. The results found that only taxes on goods & services (Indirect taxes) and corporate taxes are negative and significant in explaining poverty in the long run-in developing countries. The policy recommendation in this paper was that taxation system should be designed in such a way as to change in income received must be more than the change in tax paid by the poor.

A study was conducted by Tariq et al. (2014) about the relationship of direct and indirect sources of poverty in Pakistan. They found that unemployment, social crime, health, education and per capital income directly affect poverty while agriculture, industry, political stability and Government action regarding taxes, especially indirect tax, indirectly affect poverty. They further conclude that the imposition of taxes reduces the disposable income of people and indirect tax raises the prices of essential products, which reduce the purchasing power of the community and is a cause of poverty.

Another study was conducted by Ahmed & Awan (2021) in Pakistan to empirically evaluate the impact of taxation system on poverty in Pakistan. The results revealed that there is a positive correlation between taxation system and poverty. The authors further discussed that a high rate of indirect tax was causing poverty and widening the gap between the rich and the poor. This study recommends that the government should review the taxation system in the context of poverty level, unemployment and investment rates in Pakistan.

In this regard, a study also investigates the empirical relationship between direct and indirect taxes. Ahmed, Sial and Ahmed (2018) conducted economic growth in Pakistan. They found that indirect taxes have a negative and significant effect on the economic growth and negative growth ultimately causes poverty. This research further concluded that contribution of direct taxes out of total tax revenue is 33% and the share of indirect tax is 63% while it should be reversed if economic growth has to increase.

2.3 Legitimacy of Taxes in Shari'ah

Shari'ah has already imposed various types of financial responsibilities on the

⁵ [https://www.worldbank.org/en/topic/poverty/brief/multidimensional-poverty-measure#:~:text=The%20Multidimensional%20Poverty%20Measure%20\(MPM,of%20the%20World%20Bank's%20monitoring](https://www.worldbank.org/en/topic/poverty/brief/multidimensional-poverty-measure#:~:text=The%20Multidimensional%20Poverty%20Measure%20(MPM,of%20the%20World%20Bank's%20monitoring)

wealthy in the form of Zakat⁶ and other Sadaqat⁷. So, is it permissible to levy taxes despite the existence of a system of Zakat and Sadaqat?

Although there are different opinions among Shari'ah scholars on the matter of whether the state can impose taxes on the people or not (Abubakar, 2024). But the concluded opinion is that Shari'ah allows for a certain amount of tax to be collected in addition to Zakat and other charity considering the needs of the state for its development and management of several departments which are working under its supervision. As stated in a blessed Hadith of Holy Prophet (peace be upon him): "Your wealth has rights other than Zakat⁸." That is, despite paying Zakat, the state can impose various types of financial obligations over a wealthy person. In this regard, famous Hanafi scholar Abu Jaafar Al-Balkhi says: "if the ruler imposes taxes on the people in their interest and benefit, then it is obligatory on the people to pay taxes⁹."

Now, an important question arises here as to whether any tax other than Zakat was imposed on the wealthy during the time of the Prophet (peace be upon him) and the time of the Rightly Guided Caliphate (*Khilafat-e-Rashida*) or not. As per the available information, the taxation system was not practically prevalent until the time of the Prophet (peace be upon him) and even the time of Hazrat Abu Bakar Siddique (May Allah Almighty pleased with him) because at that time, the financial needs of the state were limited, so funds were immediately collected for sudden obligations i.e. there was no compulsion to collect it. For example, on the occasion of the Battle of *Tabuk*, the Prophet (peace be upon him) appealed to the companions for financial assistance in view of the urgent need for funds for *jihad*, so everyone who had the resources contributed according to their means and financial capability.

The above-mentioned example shows that there was no formal taxation system in the Islamic state in the early times of Islam. However, there are many such cases in the *Sunnah* of the Messenger of Allah (peace be upon him) that clearly indicate the permissibility of collecting taxes. That is, the Islamic state can impose welfare and fair taxes wherever it deems necessary and spend the collected taxes on the welfare of the people and the state, thereby accelerating their economic and spiritual development as well. In this way, the wealth of the wealthy people

⁶ Al Quran, 02:43

⁷ Al Quran, 51:19

⁸ Al-Timizi hadith no. 659

of the society will ultimately benefit the state as well as the poor to eliminate poverty (Ghiffari, 1979). Further, the intention of the *Shari'ah* is that the flow of wealth should not remain in one direction, but rather its fruits and benefits should be spread to all classes in the society⁹.

From the discussion so far, it can be understood that the *Shari'ah* has allowed the collection of taxes in addition to obligatory charity like Zakat with the following basic conditions:

- I. Taxes should be collected only from the rich persons.
- II. The tax rate should not be oppressive but should be such that people are paying it with ease and happiness.
- III. The tax should be of a welfare nature, that is, the tax is being used for the welfare of the state and to reduce the economic problems of the people. And not to meet the unnecessary expenses of the rulers¹¹.

The practice of collecting taxes under a regular system at the state level began during the rule of Hazrat Umar Farooq (May Allah please with him). And since then, this process has continued in every era till now. So, during the time of Hadrat Umar (May Allah please with him), when the scope of the Islamic state expanded, the economic needs also increased, so he imposed taxes in the form of *al kharaj* (a tax that an Islamic state levies on conquered land.) and *al ushoor*, then in later times, the jurists imposed taxes in the name of *al zar'ib* and *al nawa'ib*. In this regard, the time of the Caliph Harun al-Rashid is very important. He requested Imam Abu Yusuf to write a book for guidance regarding the running of the state's affairs, especially the collection of *al kharaj*, *al ushoor*, *zakat*, *sadaqat* and *jawali*. He further requested to give guidance on their distribution for the welfare of the state and the public. On this request, Imam Abu Yusuf wrote his famous book "*Kitab al-Kharaj* (book of taxation)", which is the first book in Islam on the taxation system (Mubasher, 2007).

2.4 Islamic Perspective on the Current Taxation System and its Shari'ah appraisal

Islam provides such an economic system, the most important aspect of which is the observance of moral values, mercy with each other and cooperation among the society (Ghazi, 2010). And since tax also comes under the economic system,

⁹ Radd ul Muhtar, 2:336

¹⁰ Al Quran, 29:7

it has been ordered to keep the moral aspect in mind, too. Whereas the current taxation system has been established under capitalism, which is beyond all kinds of moral responsibilities, so the moral aspect is not given much importance while implementing taxes in this system. Then, by imposing taxes on the people, they are made to face economic problems and their lives are made more difficult (Abdullah *et al.*, 2015)

Therefore, the jurists have allowed the imposition of taxes in the light of the *Quran* and *Sunnah* on dire needs basis and for public interest, but they have mentioned a strict condition that it should not suck the blood of the people, but rather there should be enough taxes that the people can easily pay (Shakoor *et al.*, 2018) Thus, Shah Wali Ullah writes:

“Heavy taxes force the people to disobey and rebel against the government and force them not to pay the taxes. Therefore, light taxes are the best for the state interest and the relevant authorities should think about it. Most of the taxes are misused by the state authorities, due to which essential public interests and national problems are not solved, which leads to instability in the state¹²”.

In terms of indirect taxes, it is also very important that it must not be imposed on daily necessities like rice, sugar, and other groceries. However, if people in the society become fond of luxury goods and spend a large part of their income on purchasing these goods, then there is scope for imposing tax on such goods under the principle of indirect taxes. Especially, if the trend of imports of luxury goods increases, it becomes necessary to impose it Dahraj (2023) because there is not only a direct loss due to import of goods where domestic resources are used in non-social activities, but the country's valuable foreign exchange has also started transferring to other countries. Due to the shortage of foreign exchange, the state often faces an economic crisis, as in 2023, the level of domestic exchange had decreased so much that the country was close to bankruptcy. To avoid this bankruptcy, the government of that time had to make a lot of efforts and had to take foreign loans on heavy terms and conditions (Rana, 2023). There was a shortage of foreign exchange, which led to Sri Lanka going bankrupt in 2022. The country's system collapsed and the country was torn apart by internal disorder (Jiang, 2022).

So, taking indirect tax as a whole has no reasonable justification. Because it

¹¹ Abu Zuhra Muhammad, Malik Hayatu hu wa Asruhu Aaraohu al Fiqhiyah, p:427

further degrades those living below the poverty line. Despite not being rich, they pay taxes to the government like the rich, meaning that people who should receive assistance from the state are giving the money they earn from their hard work or donations to the state in the form of taxes. Interestingly, the share of indirect taxes in collected taxes in Pakistan is higher than the direct taxes. For example, in the federal budget 2021-2022, the total budget volume was PKR. 5829 billion, in which the estimated revenue from indirect taxes was PKR. 2,182 billion while the estimated revenue from indirect taxes was PKR. 3,647 billion, which was 52.57 percent of the expected revenue from taxes of PKR. 5829 billion.

With some minor differences, the same situation is also in the recent budget 2024-25, under which the total tax revenue is estimated at PKR. 12,970 billion, of which indirect taxes are PKR. 7,458 billion and direct taxes are Rs 5,512 billion. Here too, the indirect tax rate is higher than direct taxes, i.e. 57.50 percent.

Now, let us examine the status of indirect taxes taken from the poor in the light of *Shari'ah* injunctions. As it was written earlier, the jurists have allowed taxes to be collected for the efficient running of the state affairs. But these taxes can only be levied on the rich and the elite, so they discourage indirect taxes and strictly prohibit their collection. Therefore, all the jurists condemned the cruel taxes in the strongest terms and in support of their position, they presented the behavior of Hadrat Umar (may Allah be pleased with him) as evidence. Thus, in the Book of *Al-Kharaj*, it is stated:

"Once Hadrat Umar (may Allah be pleased with him) was returning from Syria and during the journey, he saw some people standing in the sun. When he asked, he was told that these people were being punished for not paying the Jizya (tax collected from non-Muslims). Thereupon, he strictly forbade the tax collectors from this cruel behavior and said:

"I wonder if you have not obtained this by oppressing the people?" The collectors of the Jizya said, "By God, we have taken it with gentleness and transparency." Hadrat Umar asked, "Without any beating or hanging?" They replied, "Yes!" (On hearing this) Hazrat Umar said (in gratitude to Allah Almighty) that all praise is due to Allah Almighty, Who did not cause this oppression by my hand, nor during my caliphate¹³.

¹² Sha Wali Ullah, *Hujjat ul Allah al Balighah*, vol:1, p:93

Imam Abu Yusuf, while advising Caliph Harun al-Rashid, wrote:

“The effect and reward of doing justice and refraining from injustice to the oppressed is obvious. In addition, it increases the collection of taxes, and the country’s resources are blessed. Whereas oppression destroys the blessing. As a result of taxes collected with oppression, cities are destroyed, and disorder arises everywhere in countries.”

Keeping in mind this advice of Imam Abu Yusuf (may Allah have mercy on him), if we examine the current economic situation of our beloved homeland, the truth emerges that the country is currently facing the worst economic crisis. The economic crisis is such that people are committing suicide along with their families due to poverty and bankruptcy.

3. Methodology

In this study, secondary data was collected from already published reports of FBR for the tax years 2010-11 to 2023-24. There are two types of taxes, direct and indirect, in the country. Both types of taxes’ data were collected from different published reports and articles. There are two main objectives of this study, to evaluate the impact of indirect taxes on exacerbating poverty in the country and to analyze indirect taxes implication under the principles of Shari’ah. For the first objective, we used four variables, Indirect taxes as dependent variable while three variables, poverty, inflation and minimum daily wages as independent variables. All variables’ data were collected and analyzed critically with graphical presentations. The change in inflation and minimum daily wages was found and its values were compared with the change in indirect taxes by adopting an empirical approach. The descriptive analysis with graphical presentation was also used to present the results. As far as the second objective is concerned, critical analysis of the existing literature along with descriptive analysis were performed to find out the results. Furthermore, Shari’ah bases for both direct and indirect taxes were also critically discussed. To analyze the Shari’ah concerns related to indirect tax and its impact on poverty, a mixed method approach was used in which both qualitative and quantitative techniques can be used. In this research, we are interested to discuss and elaborate the Shari’ah legitimacy, Islamic legal text, scholarly opinions and Fatawa concerning taxation and social justice. Furthermore, this research also finds and evaluates the Shari’ah principles

¹³ الخراج لابي يوسف، جلد: 1، صفحہ: 125، مطبوعہ المكتبة الازهرية للتراث

relevant to indirect taxation, fairness (Adl'), prevention of hardship and right of the poor. Therefore, after a detailed discussion with the researchers, practitioners, Shari'ah scholars and relevant field experts, we adopt critical analysis of literature review and descriptive statistics techniques to describe the results and conclusion. As far as the impact of indirect taxes on poverty is concerned, secondary data of indirect tax was used and compared with poverty, inflation and minimum daily wages. The change of indirect taxes was compared with change in inflation and minimum daily wages. Graphical presentation along with descriptive statistics were also used as techniques of analysis to find out the results. Due to the nature and availability of data, descriptive statistics and critical analysis of literature review as well as graphical presentation are suitable techniques to find out the desired results.

4. Results and Discussions

The data given below clearly shows that the indirect tax rate in Pakistan is higher than the direct tax rate. According to a report by the United Nations Development Program (UNDP), the number of poor people in the country is currently many times higher than the wealthy (Ahmed, 2025). As it is showed in the following data of 2010-11 to 2023-24¹⁴.

Table 4.1 Share (%) of Direct and Indirect Taxes

Years	Direct Taxes %	Indirect Taxes %
2010-11	39	61
2011-12	38	62
2012-13	39	61
2013-14	40	60
2014-15	39	61
2015-16	40	60
2016-17	40	60
2017-18	38	62
2018-19	38	62
2019-20	38	62
2020-21	36	64
2021-22	37	63
2022-23	46	54
2023-24	49	51

¹⁴ <https://download1.fbr.gov.pk/Docs/202411516115312997FBR-REVENUE-DIVISION-YEAR-BOOK2023-24.pdf>

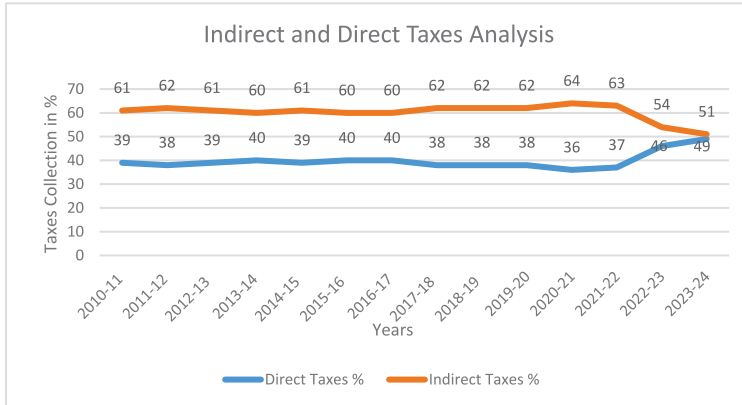


Figure 4.1 Indirect and Direct Taxes Analysis

The above given graph shows that indirect taxes are higher than direct taxes which directly hit the poverty in the country without segregation between the poor and the rich. Everyone must bear these taxes on consumption of products. Even these taxes are taken out of the pockets of 40.5 percent of the poor of the total population of Pakistan. These poor people are forced to pay up to 18 percent tax on every item purchased without their consent (Ahmed et al., 2024). When a person earning one and a half dollars a day gets petrol worth one hundred rupees in his motorcycle at a petrol pump, he also has to pay the same amount of tax as a person sitting in a car worth five crores. What could be more unjust and cruller than this?

A study was conducted by Martines, Vulovic & Lui (2011) in which they found that indirect taxes remained higher than direct tax. As the nature of indirect taxes imposed on basic products and services is without segregation of income level, it affects general population including the poor. Another study was conducted by Voto & Ngepha (2023) where researchers examined the effects of direct and indirect taxes on poverty in developing countries. The researcher used panel data of 37 developing countries. The result reveals a significant impact of direct and indirect taxes on the poverty level of developing countries. The research further recommended a fair treatment with the poor populations.

A large part of indirect taxes is generally collected from sales tax, excise duty and customs duty. Whereas excise duty is imposed only on the company’s manufacturing items only when the items are being manufactured in a factory.

However, this tax is not imposed on all types of items but on specific items such as items that are sold in large quantities or whose use is having negative effects on human health or the environment. The aim is to restrict people from buying these items such as tobacco products, and cigarettes and alcoholic beverages, etc. As far as customs duty is concerned, it is imposed only on imported and exported items as a result of cross-border business. It is levied only on goods, not on services, and paid by the importers or exporters to the state.

It is also pertinent to note that although excise and customs duties are initially paid by the manufacturers or importers/exporters respectively, these burdens fall ultimately on the buyer of those goods because the manufacturers as well as the importers/exporters include the taxes paid in the price of the goods and take the money they have paid from the consumers (Rana, 2020⁴). Thus, the burdens of all types of indirect taxes (general sales tax, excise duty and customs duty) falls on the consumers themselves. 40.5 percent of these consumers are those who are living below the poverty line, but despite poverty, they are forced to pay taxes, without which they have no choice (Aslam, 2015).

Muhammad Ahsan Rana has written about this fact in his famous book “*Hein Kawakib Kach*” in the following terms:

“Most of the indirect taxes are paid by low-income people and poor workers. Although their per capita income is less than that of the rich, their total income is more than that of the high-income people due to their large number, so they also pay more taxes. Let’s look at some statistics related to Pakistan. The United Nations Development Program (UNDP) has presented statistics on poverty and economic inequality in Pakistan in a recent report¹⁵. According to this report, the bottom two quintiles of the population are living below the poverty line, and the third and fourth quintiles consist of low-income people. The UNDP estimates that about half of Pakistan’s total income goes to the top quintile of the population and half to the remaining quintiles, of which the bottom quintile accounts for only 6.5 percent. According to them, the tax ratio of the upper quintile (which includes only the rich class) and the remaining four quintiles (which includes those living below the poverty line and the general poor) is 3.6:1, respectively, meaning that

¹⁵ <https://data.undp.org/poverty-and-inequality>

if the upper quintile pays one rupee, the other pays 3.60 rupees. But the maximum benefit of the resources obtained is delivered to the upper quintile.

The clearest proof of this is the 85-kilometer ring road around Lahore city at a huge cost of PKR. 185 billion. It is obvious that this long road has been built by the government with tax money, in which a large part of the money is indirect taxes, and in this part too, more than three times the tax paid by the rich has been levied on the poor people living in Pakistan. But who are the direct beneficiaries of this ring road? It is obvious that it is those people whose share of tax is less than the poor. This ring road has been built for the convenience of the rich residents of the societies that have become like self-sufficient plants by destroying agricultural lands around Lahore. This is the situation of all the expensive projects built with taxes in Pakistan, a large part of the tax spent on their construction came from the pockets of the poor, but most of the benefits are being received by those who are already privileged from the national income. While the poor people are under the influence of a double-edged sword.

In the last 14 years, minimum daily wages have increasing trended overall, however, there is need to discuss whether these wages increase with the rise in inflation. The trend of minimum daily wages with change in percentage is given in the graph below:

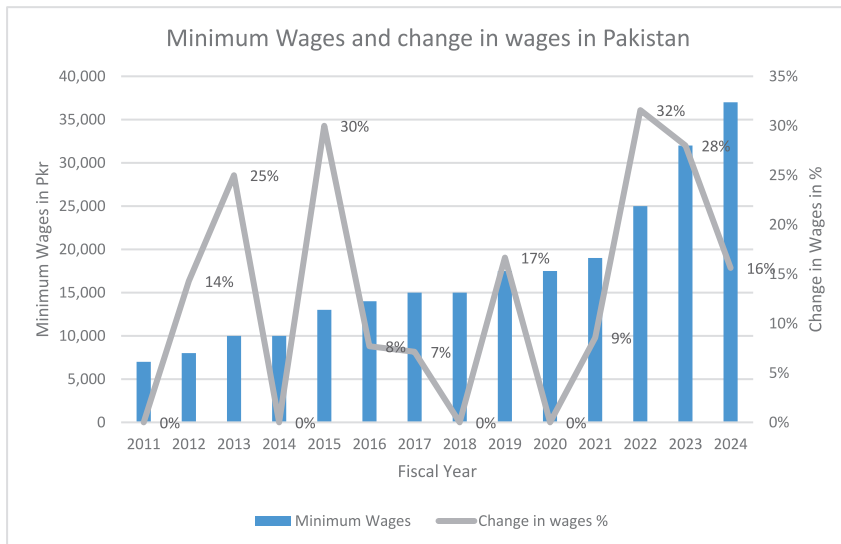


Figure 4.2 Minimum Wages and Change in Wages in Pakistan

An increase in daily wages in Pakistan has the potential to significantly impact poverty levels. By raising the income of low-wage workers, it could increase their purchasing power, stimulate local economies, and improve overall living standards. However, the effectiveness of this strategy depends on various factors, including the magnitude of the wage increases, the prevailing economic conditions, and the implementation of supportive policies to ensure that the benefits reach the most vulnerable populations. However, the above graph shows that the change in wages is not as per the change in inflation in Pakistan, which affects the purchasing power of the customer and may cause poverty in the region. Indirect tax burden on daily wages also affects the poverty trend.

A study conducted by Jaffari, Farooq & Munir (2016) supports our discussion. This study evaluates the effects of inflation on living standards and income. Empirical approach was adopted on primary data. The results revealed that inflation highly affected the income and living standard. The research further advises that change in income level should be more than inflation. Another study that supports our discussion was conducted by Ahmed, Ahmed & Donoghue (2011). This study reveals that indirect taxation affects investment, income and consumption level and an increase in poverty. This study recommended a gradual approach to tax reforms that can make the adjustment process less painful. One more study concluded that the lowest income households are suffering disproportionately from the inflation increase and increase in taxes on daily consumption products (Claeys, & Guetta, 2022).

The inflation rate and change in inflation rate in percentage are also given in the graph below for better understanding of the situation.

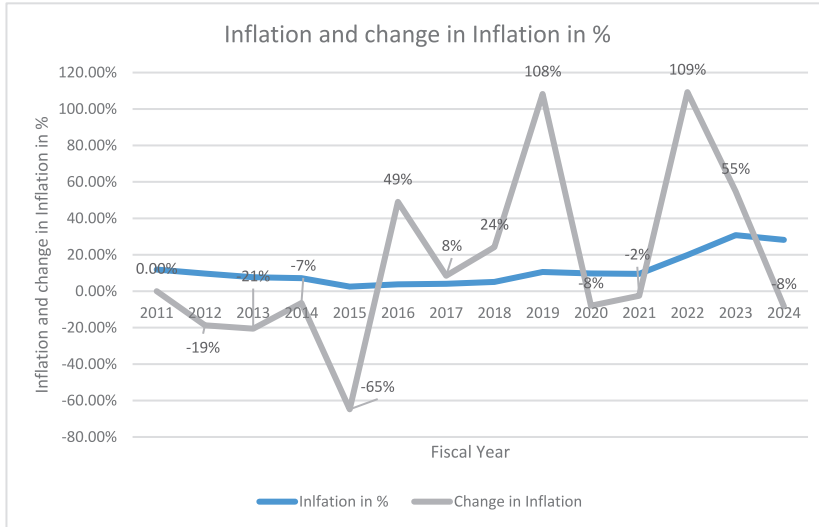


Figure 4.3 Inflation and Change in Inflation

Now we are going to compare the change in minimum daily wages with change in inflation in percentage and discussed the matter in detail. A comparison between change in minimum daily wages and change in inflation is given below in Figure....

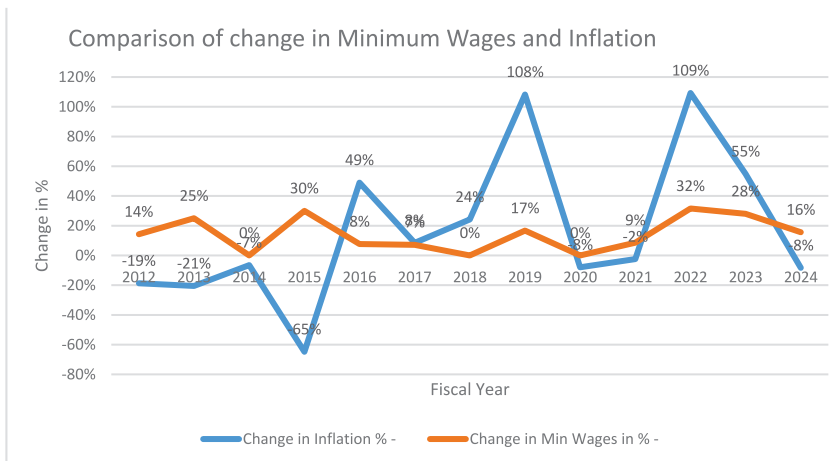


Figure 4.4 Comparison of Change in Minimum Wages and Inflation

The above graph shows that the recent years in Pakistan have seen a complex interplay between daily wages and inflation. While daily wages have shown some

growth, the pace of increase has often lagged the rate of inflation. This disparity has eroded the purchasing power of low-wage workers, making it difficult to meet the basic needs and exacerbating income inequality. The persistent gap between wage growth and inflation underscores the need for policies that ensure fair wages and protect workers from the effects of rising prices (The Economic Times, 2024).

An article published in Tribune Express (2024) supports our point of discussion. This article expressed that minimum wages are a fundamental question of social justice and parity. Minimum wages declared by the Government often fall off covering basic living expenses. Inflation has eroded the purchasing power of the wage earners, pushing many into a cycle of poverty despite their employment. The rising cost of life's essentials including food and housing, have outpaced wage increases, leaving many workers in a precarious financial situation¹⁶. Another article published by Business Recorder (2025) explicitly states that real wages for daily wage earners have been in "free fall" since July 2019, due to inflation relentlessly eroding their buying power and are a cause of poverty in the country¹⁷.

Poverty is a significant contributor to suicide rates in Pakistan. Individuals struggling with financial hardship often experience immense stress, hopelessness, and a sense of despair. The inability to provide for basic needs, such as food and shelter, for themselves or their families can lead to feelings of inadequacy and worthlessness. According to the United Nations subsidiary World Health Organization report "Suicide Worldwide", in 2019, 19,331 people committed suicide in Pakistan during 2019, of which 14,771 were men and 4,560 were women. According to this report, 8.9 people per 100,000 people in Pakistan commit suicide and 70,300 people worldwide commit suicide every year. This rate of death by suicide is much higher than deaths from malaria, AIDS, breast cancer, war and mass murder combined.

5. Conclusion

In conclusion, indirect taxes present a significant impediment to the smooth and equitable development of a nation. This impact affects society by two ways. Firstly,

¹⁶ <https://tribune.com.pk/story/2492355/enforcing-minimum-wage>

¹⁷ <https://www.brecorder.com/news/40346752/falling-inflation-rising-misery#:~:text=Real%20wages%2C%20the%20true%20measure.free%20fall%20since%20July%202019.>

Indirect taxes exacerbate poverty by placing a financial burden on essential goods and services, disproportionately impacting low-income households. As a result, they are forced to make difficult choices, often sacrificing necessities like food, healthcare, and education. Secondly, indirect taxes fuel public resentment towards the government. When citizens feel that the taxation system is unfair and burdensome, it erodes trust in the government. This can lead to social unrest and even political instability.

In addition to the above, it is necessary to establishing a robust and controlled mechanism for tax collection is crucial for a nation's fiscal health and equitable development. A well-functioning system ensures adequate revenue for public services while minimizing undue burden and fostering taxpayer compliance. Indirect taxes applied on essential livelihood, create undue hardship, disproportionately impacting lower-income households and hindering economic mobility. Focusing indirect taxes on non-essential items allows governments to generate revenue without compromising the basic necessities. This approach fosters a more equitable tax system, ensuring those struggling to meet fundamental needs are not further burdened. Controlling indirect taxes can have significant future implications for poverty reduction. By reducing or restructuring these taxes, governments can alleviate the financial burdens on the poor, increasing their disposable income and improving their living standards over time. This can break the cycle of poverty across generations.

Lowering indirect taxes on essential livelihood may decrease government revenue, potentially affecting public services. This revenue loss could be partially offset by improved Zakat collection. A well-structured and efficiently managed digital Zakat system, ensuring transparency and proper distribution, could supplement government funds and support social welfare programs, mitigating the impact of reduced tax revenue. Furthermore, there is a need of widespread public awareness campaign regarding Zakat's obligatoriness. In addition to this, a well-organized Ushr/Half Ushr (Zakat of crops/vegetables/fruits) collection system may be introduced by the government which may reduce the social welfare expenses of the government. Despite focusing on indirect tax, the state can bring informal sector into the tax circle through a simplified mechanism of collection. The State should also minimize its non-productive expenditures which are increasing day by day. Furthermore, enhancing transparency and

accountability in public procurements and expenditures with independent audit may be helpful to prevent wasteful spending.

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