Debate on Policy Issues in the Field of Zakat on Islamic Bank Business

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Abstract

Purpose – The purpose of this paper is to discuss zakat for business entities, in this regards Islamic banking institutions. There is a debate on whether or not business entities are obliged to pay zakat. However a sort of consensus has been concluded that a business entities owned by Moslems should pay zakat, at least for the Moslems’ owner.

Design/methodology/approach – This paper is conceptual in nature describing why business entities should pay zakat based on the rationale that business entities play a role to create value added for the welfare of the community. Should zakat be applied to gross income, gross-profit, net-profit of the business entities or only the profit attributed the Moslem owner only or else. These are the unsettled area that deserved exploring

Findings – Discussion in this paper attempts to shed lights on matters pertaining zakat such as zakat chargeability, and their calculation, determination of zakat base and zakat eligibility of assets and liabilities. From practices exposed in this paper, such as Bahrain, United Arab Emirates and Malaysia business zakat on the Islamic banks entities are implemented. In the first two countries zakatable items is clearly mentioned, i.e. the banks’ reserve, and retained earnings, while for Malaysia no specific items being explicitly mentioned but business zakat.

Research limitation/implications – This paper proposes application of zakat on business entities, however consensus on this matter has not been established yet.

Originality/values – The paper initiates a new policy issues on zakat implementation especially on the Islamic bank businesses.

Keywords – Zakat, nisab, net wealth, Islamic bank, business entities.

Paper type – Conceptual paper.
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1. Introduction

In Islam, wealth, property and material possessions are considered one of the blessings of God. One of Allah’s most magnificent attributes is that He is al-Razzaq (The Provider) and everything that we may have in our possession is ultimately from Him. Anything we have is therefore only ours for the short period of our lives and the test we face is what we do with what we have been provided with by al-Razzaq. As with all blessings, the Day of Judgement will be Yawm al-Hisaab (The Day of Account), when our use of God’s blessings will be analyzed and judged.

In order to keep an economy flourishing, the money (as part of our wealth) needs to be kept in circulation, passing from the rabbul mal to Islamic banks who need it, in exchange for goods, services or profit. Trade (Tijara) and investment (Istithmaar) are two ways that this circulation is maintained. Another way that will keep money circulating is via zakat.

However, much of the discussions on zakat for company (especially zakat for businesses) are mainly focused on the non-financial companies or business entities, see for example Hamat (2009) and Abu Bakar (2007), Adnan and Abu Bakar (2009). In addition, the current discussion on zakat

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4 There is a famous narration of the Prophet (s) where he said, “Charity does not decrease wealth” [Muslim]. This hadith is usually taken to mean that by giving charity, Allah will bless your wealth and give you more through other means; a perfectly valid explanation which is understood from the following Qur’anic verse, “The paragraphble of those who spend their substance in the way of God is that of a grain of corn: it growth seven ears, and each ear Hath a hundred grains. God giveth manifold increase to whom He pleaseth: And God careth for all and He knoweth all things.” [Qur’an 2:261]
focuses on the zakat of individual assets, such as debt, and equity and none is done to examine the zakat payment for Islamic bank as a business entity.

The aim of this paper is to propose a methodology in the calculation of zakat payment in ensuring that all banks receive a fair treatment. This is achieved through streamlining the method for the calculation of zakat payment and also by enhancing the level of transparency to address the information asymmetry among the users of financial statements. The remaining discussion of this paper will be divided into several sections.

2. Shariah Requirement on Zakat Payment

A paying zakat on one’s business wealth is based on the Islamic concept of wealth being bestowed by Allah, the real owner of all wealth, as a trust. In general, the studies on Zakat almost agree on many things, especially on the types of zakat, Nisāb (taxable limit) and haul, eligibility (Muslim and full ownership).

Many verses in the Qur’an order Muslims individual to pay zakah (charity) as it is as important as prayer. This shows how important the order to pay zakat is for Moslems to obey. Because through the zakat Allah attests Moslems on the sincerity in utilising the wealth that Allah bestows them. In this respect, zakat makes those whom obliged to pay to be bountiful with others in need. Hence it reflects sharing and caring among Moslems. It also indicates a purifying process of the Moslem’s self and his/her wealth in order to achieve barakah from Allah. The following are several verses on the obligation to pay zakat /charity.

And [recall] when We took the covenant from the Children of Israel, [enjoining upon them], "Do not worship except Allah; and to parents do good and to relatives, orphans, and the needy. And speak to people good [words] and establish prayer and give zakah." Then you turned away, except a few of you, and you were refusing. (al-baqarah: 83)

Other Qur’anic verses related to zakat include; al Baqarah (verses 110, 177,195, 219, 261, 265, 277); al-Nisa (v.162); al-Ma’idah (v.55); al-Isra’ (verses 26-27, 29-30); al-Rum(v.39); al-Hadid (v.18)

Those verses are all highlighting the principal importance of obeying Allah’s instructions in spending for the sake of Allah through zakat, infaq and sadaqa, and their rewards and punishments. With regards to paying zakat the detail of the order can be followed through the saying of the Prophet Muhammad SAW.

Ali (peace be upon him) reported that the Prophet (may peace be upon him) said: “I have forgiven the sadaqa on horses and on slaves. Then bring sadaqa on dirhams at the rate of one dirham for every forty. But nothing is payable on 190 dirhams. And when it (wealth) reaches two hundred dirhams then five dirhams shall be payable. (10:28), (Khan 1989 p.189)

Samura b. Jundub reported: “After this (praise of Allah and benediction on the Prophet); Prophet ordered us to pay sadaqa on our merchandise (stock-in-trade).” (10:30), (Khan 1989 p. 191)

Salim reported on the authority of his father that Allah’s Messenger (may peace be upon him) wrote a letter pertaining to sadaqa but did not despatch it to his governors till he passed away. Then he conjoined it with his sword and Abu Bakr executed it till he also passed away. Subsequently ‘Umar implemented it till he also passed away. It contained the following instructions: One goat shall be charged on five camels; two goats on ten camels; 3 goats on 15 camels; 4 goats on 20 camels; one bint makhad on 25 to 30 camels; And if it exceeds by one (i.e. reaches 36) then one bint labun will be charged to 45 camels. And if it exceeds by

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5 Refer to barakah paper….and other papers
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7 Ownership is proven in the capital share or bank shares owned by the owner and not including any shared capital made up of or bank shares that were purchased by borrowed money.
8 Bint Makhad: A She camel in her second year
9 Bint Labun: A She camel in her third year
one (i.e. reaches 46), one hiqqa\textsuperscript{10} shall be charged up to 60 camels. And if it exceeds by one (i.e. reaches 61), one jadh’a\textsuperscript{11} will be payable up to 90. And if it exceeds by one (i.e. reaches 91), two hiqqas shall be payable up to 120 camels. And if the camels are in excess of 120, then one hiqqa on every 50 camels, and one bin labun on every 40 camels (shall be payable).

And in goats: on every 40 goats one goat till it reaches 120. And if it exceeds by one (i.e. reaches 121), then 2 goats (will be payable) up to 200 goats. And if it exceeds by one over 200 (i.e. reaches 201), then 3 goats (will be payable) up to 300. And if the flock is larger than this, then one goat will be payable on every 100 goats. And nothing shall be charged until it is one hundred. Neither the collected herds will be scattered (for assessment) nor shall the scattered cattle should be collected (for assessment) to evade sadaqa. And partners shall bear the burden of sadaqa in proportion to their assets. The decrepit and defective cattle will not be accepted in sadaqa. The narrator said: “Zuhri (one of the reporter) said:”When the tax collector used to come, he would divide the entire (wealth) into 3 parts: substandard, average, superior. Then he would receive sadaqa from the average part.” And Zuhri did not mention the cows.” (10:34), (Khan 1989 p.193-194).

Basically, zakat can be classified into two types, obligatory and recommended. Obligatory Zakat is again of two types, the Zakat of wealth and the Zakat of body (Fitra). The Zakat of wealth is for nine items:\textsuperscript{12} Four food grains (Wheat, barley, dates and dried grapes); Three quadrupeds, (Sheep or goats, cows and camels) and two types of coins, (gold and silver).

Zakat of food grains becomes obligatory when wheat, barley, dates or resins reach a particular quantity (Nisāb). The Nisāb (taxable limit) is fixed at 40 mithqal less than 280 Tabrizi mounds approximately equal to 847 Kilograms. If the cultivation of wheat, barley, dates or resins was carried out by rain water, stream/river or from the moisture of the earth (like the lands of Egypt etc.) the Zakat payable is one-tenth of the total yield. But if it was cultivated with well-water etc. the Zakat is 1/20 (twentieth part).

However, the list of zakat is expanded to cover: savings (including deposits, trust funds; and employee provident funds); wages; business; and shares. Business zakat is obligatory for all types of businesses - be they sole proprietorship, limited partnerships or public companies - so long as Muslims have interests in them.

In Malaysian case, the National Council of Islamic Affairs (NCIA) in December 1992 decided that, as quoted in Paiman (2009) it is compulsory for a business entity to pay zakat under the following requirements: (i) the business entity is owned by Muslims and independent; (ii) have complete control; (iii) exceed particular level (nisab); (iv) complete one calendar year (Islamic) or 354.3 days (haul); (v) the rate is 2.5%; (vi) for a company jointly owned by Muslim and Non-Muslims, zakat is compulsory on the shares owned by Muslims only. Again this provision provides a clearance on that the business entities have to pay zakat for their business subject to all requirements set. However it does not prescribe on what are the zakatable items under business entities.

Zakat on business entities was originally imposed on inventories or goods for trade. However, this premise has been redefined by jurists. They have broadened the scope of goods for trade (urud tijarah) to working capital used in business operations.

Generally, zakat is 2.5% of surplus wealth that a company has possessed for a full lunar year, with calculation be based either the growth capital method or the working capital method.

There are many rules and differences amongst scholars about exactly what is what regarding Zakat.\textsuperscript{13} But, the basic rule is that fixed assets are not liable for zakat but all other assets, categorised into current assets, should be included in surplus wealth calculation, especially for business zakat. Meaning that all items that are included into working capital is subject to zakat. Therefore it can be

\textsuperscript{10} Hiqqa: A She camel in her fourth year

\textsuperscript{11} Jadh’a: A She camel in her fifth year

\textsuperscript{12} Refer to which hadith ….

\textsuperscript{13} Some companies may use this as an excuse for not paying at all by saying, “It’s all too confusing and complicated for accountant”. Others may try and use the different rules to try and pay as little as possible. Allah, subhanahu wa ta’la, wants good intentions behind any of our actions.
concluded that business zakat is obligatory, however, we still have to determine precisely on what are the zakatable items on the Islamic bank business.

3. Accounting Standards for Zakat on Business

Basically, the accounting standard bodies, such as AAOIFI (Financial Accounting Standard (FAS) No. 9 or FAS No. 9) and MASB (Technical Release-i 1 or TR i-1), have agreed on several related matters to zakat such as definition, classification, recognition, measurement, presentation and disclosures. Zakat on business is zakat that is obligatory to be paid on business property whether it is based on production, mining, fishing, shipping, supplying, agriculture or service providing.

The account classification and recognition of zakat in both FAS no. 9 and the TR i-1 are defined quite similarly. For a business entity who pays zakat, such amount of zakat is recognised as an expense and included in the income statement for the period in which it is incurred. But, scholars such as Adnan and Abu Bakar (2009) argue that the consequent treatment may be agreeable to the expense concept in accounting, it does not augur well with the intended spirit of paying zakat.

The fourth matter is regarding the measurement and zakat determination. FAS no. 9 offers two different methods. The Net Assets Method is formulated as follows:

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\text{Zakat payment} = 2.5\% \times \left( \text{assets subject to zakat} - (\text{liabilities that are due to be paid during the year ending on the date of the statement of financial position} + \text{equity of unrestricted investment accounts} + \text{minority interest} + \text{equity owned by government} + \text{equity owned by endowment funds} + \text{equity owned by charities} + \text{equity belonging to not-for-profit organizations excluding those that are owned by individuals}) \right) \tag{1}
\]

And, the Net Invested Funds Method use the following formula:

\[
\text{Zakat payment} = 2.5\% \times \left( \text{Paid up capital} + \text{reserve} + \text{provisions not deducted from assets} + \text{retained earning} + \text{net income} + \text{liabilities that are not due to be paid during the year ended on the date of statement of financial position} - (\text{net fixed assets} + \text{investment not acquired for trading, e.g. real estate for rent} + \text{accumulated losses}) \right) \tag{2}
\]

These two approaches are expected to produce the same result, provided that the items included are consistently classified and valued, with due considerations given to the different valuation basis in them (paragraph 8).

MASB TR i-1 also suggest two methods of determining zakat base, as recommended by the Malaysian Islamic Development Department (JAKIM) in Panduan Zakat di Malaysia, published in 2001. It shows that zakat base is still subject to the interpretation of the respective zakat authority.\(^{14}\)

The fifth matter is related to the presentation. The FAS 9 of AAOIFI characterized the presentation of zakat as depending on two circumstances (i.e. the business entity which is obliged to pay zakat and the opposite situation). In the former, where a business entity is obliged to pay zakat, the zakat shall be treated as a non-operating expense and shall be included in the determination of net income in the income statement; whereas the unpaid zakat shall be treated as a liability and presented in the liabilities section of the statement of the financial position of the business entity. In addition to the above, section 2/2/3 of FAS 9 states:

“the zakat due from the business entity as well as amounts of zakat received from other sources of funds shall be presented in the statement of sources and uses of funds in the zakat and charity fund “(paragraph 12).

In the MASB TR i-1, the Technical Release requires recognition of zakat as an expense (see paragraph 4). While the presentation of zakat is highlighted in paragraph 15, where it states:

“The amount of zakat assessed for the current period shall be presented as a line item on the face of the income statement”.

The sixth matter is related to disclosure. In this regard, FAS 9 set up seven rules about disclosure:

\[^{14}\text{Refer to the following zakat authority: Malacca (Refer to}\]http://www.izakat.com/kalkulator/Business%20Calculator.html\] or Singapore\(\)http://www.muis.gov.sg/cms/uploadedfiles/corporategov/zakat/zakat_on_business_formula.pdf\)
(i) “method used for determining the zakat base and the items included in the base” (paragraph 13)
(ii) “the ruling of the Sharia’s supervisory board of the Islamic bank on issues related to zakat that are not included in the standard” (paragraph 14).
(iii) “whether or not the Islamic bank as a holding company pays its share of zakat obligations in its subsidiaries” (paragraph 15).
(iv) “the amount of zakat that is due from each share (if the bank does not pay zakat)” (paragraph 16)
(v) “the amount of zakat that is due from the equity of investment account holders” (paragraph 17)
(vi) “whether or not the Islamic bank collects and pays zakat on behalf of holders of investment accounts and other accounts” (paragraph 18)
(vii) “the restrictions imposed by the Shari’ah supervisory board of the Islamic banking in determining the zakat base” (paragraph 19)

The disclosure requirements are set up in paragraphs 16 and 17 of MASB TR i-1. The paragraphs ask the business entity to disclose only three items: method used in the determination of zakat base; its responsibility towards payment of zakat on business; and major components of zakat. It is further stated that components of zakat may include: current zakat expense; zakat payment; zakat liability; and any adjustments recognized in the period for zakat of prior periods.

4. Issues Related to Zakat on Islamic Banks Business

The current guideline on the presentation of financial statements for Islamic banks (or GP8-i), as issued by Bank Negara Malaysia in 2003. The aim is to ensure the consistency and comparability of these statements among the Islamic banks. In addition, the guideline was introduced in complying with the provisions of the Companies Act 1965, accounting standards (AAOIFI FAS 9, MASB FRS i-1, and MASB TR i-1) and shariah requirements.

In preparing the financial statement, the guideline states the accounting policies on the following subjects: basis of accounting; basis of consolidation (whether Islamic banks have subsidiary companies or associated companies); intangible assets; basis of valuation; income recognition; forward exchange contracts; foreign currency translations; taxation; zakat; cash flow statement; and policy on profit equalization reserve. However, the information given on the accounting policy of zakat is limited to: the payment of zakat on the business; and an additional information that zakat is paid on behalf of shareholders or depositors. However, several issues related to zakat on Islamic bank business are encountered.

a. Issue I: Zakat Chargeability of an Islamic Bank Entity

In Malaysia, the most common types of businesses are sole proprietorships, partnerships and companies.

Sole proprietorships usually have just one business owner, and only Malaysian citizens or permanent residents can register. Personal names or trade names can be used as business names, and the Application of Business Name form must be filled in before a business can be registered. Certain names, like those associated with government agencies or royalty (i.e. "national", "chartered" or "di-Raja") or the name of another person who is not the owner of the business cannot be registered.

Partnerships comprise two or more business partners pooling their resources in a business with a view to profit. Like sole proprietorships, only Malaysian citizens or permanent residents can register partnerships. Personal names or trade names can be used as business names, and the Application of Business Name form must be filled in before a business can be registered. Certain names, like those associated with government agencies or royalty (i.e. "national", "chartered" or "di-Raja") or the name of another person who is not an owner of the business cannot be registered.

Companies are registered legal entity formed by several persons that can own property, draw contracts and employ people. The most common type of company in Malaysia is a company limited by shares (public limited and private limited companies). Private limited companies cannot sell shares to the public, and are distinguished by the appellation "Sendirian Berhad", shortened to "Sdn Bhd" or
"S/B". Public limited companies source their capital by selling shares to the public, and are distinguished by the appellation "Berhad", shortened to "Bhd". Companies in Malaysia are governed by the Companies Act 1965. A company must have a minimum of two members, but a private limited company is limited to 50 members (public limited companies have no member limit). A minimum paid-up capital of only RM2 is needed to start a private limited company, while public limited companies need a paid-up capital of not less than RM60mil (if it seeks to be listed on the Stock Exchange). In addition, for all types business entities registration the relevant authorities reserve the right to reject any given name if it is deemed misleading or inappropriate in their opinion.

If the business entity registers with the Registrar of Companies it takes the form of a limited partnership. A limited partnership in Malaysia consists of: (i) one or more people called general partners, who are liable for all debts and obligations of the company; and (ii) one or more people called limited partners, who contribute a sum/sums of money as capital, or property valued at a stated amount. Limited partners are not liable for the debts and obligations of the company beyond the amount contributed. This has created the concept of “juridical person” and the idea of limited liability.

However, a “juridical person” is simply and truly a non-existing or imaginary person created by conventional law. This imaginary or fictitious person is regarded as a legal entity supposedly having transacting and contractual ability and powers in the same or in almost the same way as a real, living human being. It is a ‘person' existing on paper and in relation to the word ‘person' it is purely fictitious.

Although the ‘juridical person' is acknowledged and understood to be a figment of the imagination of men, as explained by Mujlisul Ulama of South Africa, it is nevertheless accorded some consequences in the capitalist system of economics. The two main consequences of the fictitious man are: the acquisition of capital from investors; and insulating the partners of the business enterprise against the debt they owe their creditors. This safeguard which the 'juridical person' provides is termed the ‘principle of limited liability'.

The theory of absolution from debt, that is, to be absolved of debt without payment or a wholehearted waiver by the creditors, is an unacceptable to Islam. Not only fictitious entities, the so-called juridical persons, but even living persons are solved of their debts by virtue of the insolvency law of the common law. Thus, when a person is declared insolvent and all his assets have been possessed and disposed of to pay his creditors, he is totally set free from all remaining debts. Thereafter when he again acquires wealth, even millions, his creditors have no right to pursue him for demanding what he owes them.

This same theory of arbitrary and legal absolution of debt, which denies the rights of the creditors, is extended to the fiction called ‘juridical person'. When a company (the fictitious entity) is declared insolvent, the claim of the creditors is limited to the assets registered in the name of the fictitious person or the ‘juridical person' in the terminology of the capitalists. The debts are simply written off and cannot be claimed from anyone. Those who had incurred the debt are let off the hook to go free to earn and become rich while those who have huqooq (rights), namely, the creditors, have to simply relinquish their rights and claims under duress of common law.

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16 Limited partners may not: (i) draw out or receive back any part of their contributions to the partnership during its lifetime; or (ii) take part in the management of the business or have power to bind the company. If they do, they become liable for all the debts and obligations of the company up to the amount drawn out or received back or incurred while taking part in the management, as the case may be.
17 Refer to the definition given by http://www.businessdictionary.com/definition/juridical-person.html and http://en.wikipedia.org/wiki/Legal_personality
18 Further discussion is given in http://books.themajlis.net/book/print/251
19 We can refer to the following hadith: Hadith Bukhari, Volume 3, Book 37, Number 492: Narrated Salama bin Al-Akwa: A dead person was brought to the Prophet so that he might lead the funeral prayer for him. He asked, “Is he in debt?” When the people replied in the negative, he led the funeral prayer. Another dead person was brought and he asked, “Is he in debt?” They said, “Yes.” He (refused to lead the prayer and) said, “Lead the prayer of your friend.” Abu Qatada said, “O Allah’s Apostle! I undertake to pay his debt.” Allah’s Apostle then led his funeral prayer.
The above discussion raises the following issues. First, if Islamic bank is licensed under the Company Act of 1965. Then, the legal entity as “juridical person” or real owner of a company needs to be “corrected”. Second, the payment of zakat is recognised as expenses. Therefore, the decrease in economic benefits due to the incurrence of debt would result in decreases in equity, and hence, less payment of zakat.

b. Issue II: Calculation of Zakat

Several scholars have agreed on the following aspects of zakat on business, such as the Nisāb (taxable limit), the basis of measurement of assets and liabilities used in preparing financial statements either historical cost or market cost; and the percentage of interest in the company owned by Muslim individuals.

From the point of shariah view, the later aspects show that zakat on business is a material proof of the Muslim’s acceptances of Islamic pillars, just as the Muslim’s acceptances of the other four pillars. In turn, the company is also permitted to practice the paying of tax and to enjoy the tax exemption from paying tax (after the zakat deduction). It shows that the company also enjoys a tax benefit as the result of the utilization of more debt. Therefore, this duality might create two results: injustice to the company’s owner\(^{20}\) and instability to the company.

c. Issue III: Determination of Zakat Base\(^{21}\)

In measuring the items on the right hand side of equations (1) and (2), the items to be included should be assessed clearly. The items, as appeared in both equations, should consider the net adjusted amount of zakat assets and liabilities used for or derived from business activities.

c.1. Zakat on Cash and Bank Balances

Zakat is payable on all cash balances and bank balances in form of balance in savings account, current account or fixed deposits including monthly income certificate or term deposits. If the amount is utilized for personal or any other use at the time of calculation of Zakat, only on the balance of the amount Zakat is payable. But if the amount has been withdrawn and is lying as cash in hand you should pay Zakat on both Bank and Cash balances added together.

c.2. Zakat on investment or dealing securities

Zakat should be calculated on investment or dealing securities at a value as on the date of Valuation. There are different opinions on the value to be adopted for valuation (i.e.) Purchase price or Market price. Most of the scholars have favored Market value prevailed.

c.3. Zakat on Sale Receivables

The amount receivable on credit sales is to be added to the total value and the amount payable to your suppliers or loans taken if any for the business is deducted to arrive at the net value on which Zakat is due and payable.

c.4. Zakat on Landed property

Zakat is not payable on the following properties. (a) Personal residential houses even if they are more in number meant for residential purposes only; (b) Property given on rent irrespective of the number; (c) Agricultural land, if meant for agricultural and farm house (if any) on agricultural land, servant

\(^{20}\) The same rate might be used. We can learn from the imposition of jizya on non-Muslims similar to the imposition of zakat on Muslims

\(^{21}\) Zakat base is defined as the net adjusted amount of assets and liabilities used for or derived from business activities that are subject to zakat.
quarters, godowns, tractors, bullocks and all implements for use at the farm; and (d) Open land owned with the intention of building a house in future for self or for the benefit of the family.

If you have sold a property which was meant for business and have entered into an agreement of sale on the balance of money receivable on the date of Zakat calculation, Zakat is to be paid on such amount receivable.

If you are a builder and in property business, (Purchase and sale or develop and sell), on all completed unsold portions you have to pay Zakat at the prevailing market value. Zakat is also payable on amounts of installments receivable on such portions after deducting loans or liabilities payable on the same.

On property in the form of building, shops, godowns or land if meant for property business Zakat is payable. There is a misconception that there is no Zakat on property even if it is for business. This is not correct. However, there is no Zakat on property occupied for running your business like shop, showroom, godown, factory building, poultry shed, cattle shed etc.

c.5. Zakat on business stock

No matter what your business is you have to pay Zakat on all Stock in Trade. The stock must be valued at Cost price (Purchase Price plus Transport, Insurance etc). If you have any bills receivable from your customers you must add the same.

Dead stock should also be taken into account at the discount rate (i.e. if sold in the open market by way of discount sale etc). You should not calculate dead stock at Purchase Rate or Cost Price. Damaged stock need not be calculated at Cost Price but at scrap value.

Zakat is payable on all business stock including old parts, scrap, cars if you are in the car business (excluding taxies, lorries, pick-ups, auto, meant for transport business). Even on pan shop stocks Zakat is payable. Hence Zakat is payable on all business stock after adding bills receivable and deducting bills payable.

c.6. Zakat on factory building, machinery and goods produced

There is no Zakat on factory building or any kind of machinery, but there is Zakat on products produced in the factory (finished stock). If there is any loan or liability on the finished stock you should deduct the same for calculation of the stock value. Similarly amount receivable on credit sales should be added to the net stock. Bad debts should be deducted from net calculation.

c.7. Basis of Consolidation

Zakat can be paid by the company itself. But if the company is not paying Zakat and a partner wants to calculate Zakat on his share in the company he should take the amount standing to his capital and loan account as per the last Balance Sheet. Add his share of profit till the date Zakat is calculated. (This has to be estimated only as it is difficult to calculate the profit in between an accounting year. Deduct any loans or drawings taken by you from the company till the date of calculation.

(a) Intangible assets;
(b) Basis of valuation;
(c) Income recognition
(d) Forward exchange contracts;
(e) Foreign currency translations;
(f) Taxation
(g) Zakat
(h) cash flow statement;
(i) policy on profit equalization reserve.

c.8. Zakat on loans, Government bonds, provident funds, LIC etc.

Zakat is payable on loans advanced by you to your friends and relatives. It should be treated as cash in hand and Zakat is payable on it. You may deduct loans payable by you if any for arriving at the net
amount. Zakat is also payable on all Government Bonds such as Indira Vikas Patrika, IDBI Bonds, Units, LIC Paid up Premiums and all such Postal Savings Certificates Etc. Zakat is also payable on Provident Funds, Earnest Money Deposits in case of contractors, Tender Deposits, Government Bills Receivable, Security Deposits etc.

c.9. Zakat on Company shares and mutual fund.

You should pay Zakat on investment in Company Shares calculated at quoted value on the date of Zakat calculation. If the share of your company is not quoted in any stock exchange, then you may use the services of a chartered accountant to arrive at the value. Similarly Zakat is payable on all Mutual Funds, private chits and chit funds.

c.10. Liabilities

If there is any Income Tax or Sales Tax payable to Government on the date of calculation of Zakat, such liabilities you may deduct before arriving at the net wealth. NOTE: Payment of Income Tax or Sales Tax does not fulfill your liability towards Zakat and you cannot deduct Income Tax payments from your net Zakat. Only tax liability, if due on the date of Zakat calculation is detectable from the net assets.

d. Issue IV: Zakat Eligibility of Assets and Liabilities

What has been agreed in considering the eligibility of assets and liabilities is based on the category of assets or liabilities. In this respect, the asset eligibility might be more understandable than the liability, due to its nature of positive feature for wealth. While for the liability since it is more of a responsibility, it might be included as a deduction of zakat calculation for the net wealth. The next crucial problem is in term of the basis for calculation of zakat for the agreed items. It also involves complexity of separating mixed assets with different maturity for the purpose of determining their eligibility.

Table 1 is typical of a balance sheet for Islamic bank in Malaysia. Discussion on business zakat for Islamic bank might be easier by looking directly at the items exposed in a balance sheet. Example is the above table where we could look into the way the assets, the liabilities and the equities of Islamic bank be categorised and exposed in the financial report, based on certain accounting principle and policy. On the assets side, we could analyze further what are basically the assets of bank consisted and composed of. The next question to address is where these assets come from, can they be treated as a real asset of the bank considering that the main assets of an Islamic bank, i.e. financing advanced to the clients, with the funds sourcing from their depositors. In this regards ownership matter is important before we arrive on determining zakatable items of an Islamic bank. It should consider that for Islamic bank asset to be included into zakatable items requires condition similar to the other subject of zakatable items, such as haul and nisab.

On the liabilities side, in general the items in this side are not zakatable items, even for each single item in the liability. In fact they will be used as a deduction when calculating the net assets. Meanwhile for the shareholder’s funds, they may be subject to zakat levies provided all requirements be fulfilled. It will be good for the mobilisation of zakat funds should we capable of arriving at a consensus on the determination of zakatable items and the calculation formula to be applied in the Islamic bank business.
Table 1: Items reported on a Balanced Sheet of an Islamic Bank Company and its hypothetically possible Zakat charges

<table>
<thead>
<tr>
<th>No.</th>
<th>Items</th>
<th>Zakatable</th>
<th>Non-zakatable</th>
<th>Nisab</th>
<th>Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.</td>
<td>Cash and short-term funds</td>
<td>√</td>
<td>√</td>
<td>200 Dirhams</td>
<td>2.5%</td>
</tr>
<tr>
<td>2.</td>
<td>Securities:</td>
<td>√</td>
<td>√</td>
<td>200 Dirhams</td>
<td>2.5%</td>
</tr>
<tr>
<td></td>
<td>– Held-for-trading</td>
<td>√</td>
<td>√</td>
<td>200 Dirhams</td>
<td>2.5%</td>
</tr>
<tr>
<td></td>
<td>– Held-to-maturity</td>
<td>√</td>
<td>√</td>
<td>200 Dirhams</td>
<td>2.5%</td>
</tr>
<tr>
<td></td>
<td>– Available-for-sale</td>
<td>√</td>
<td>√</td>
<td>200 Dirhams</td>
<td>2.5%</td>
</tr>
<tr>
<td>3.</td>
<td>Financing, advances and other loans</td>
<td>√</td>
<td>√</td>
<td>200 Dirhams</td>
<td>2.5%</td>
</tr>
<tr>
<td>4.</td>
<td>Other assets</td>
<td>√</td>
<td>√</td>
<td>200 Dirhams</td>
<td>2.5%</td>
</tr>
<tr>
<td>5.</td>
<td>Statutory deposits with BNM</td>
<td>√</td>
<td>√</td>
<td>200 Dirhams</td>
<td>2.5%</td>
</tr>
<tr>
<td>6.</td>
<td>Investment in subsidiary companies</td>
<td>√</td>
<td>√</td>
<td>200 Dirhams</td>
<td>2.5%</td>
</tr>
<tr>
<td>7.</td>
<td>Investment in an associated company</td>
<td>√</td>
<td>√</td>
<td>200 Dirhams</td>
<td>2.5%</td>
</tr>
<tr>
<td>8.</td>
<td>Property, plant and equipment</td>
<td>√</td>
<td>√</td>
<td>200 Dirhams</td>
<td>2.5%</td>
</tr>
<tr>
<td>9.</td>
<td>Tax recoverable</td>
<td>√</td>
<td>√</td>
<td>200 Dirhams</td>
<td>2.5%</td>
</tr>
<tr>
<td>Liabilities</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>10.</td>
<td>Deposits from customers</td>
<td>√</td>
<td>√</td>
<td></td>
<td></td>
</tr>
<tr>
<td>11.</td>
<td>Deposits and placements of banks and other financial institutions</td>
<td>√</td>
<td>√</td>
<td></td>
<td></td>
</tr>
<tr>
<td>12.</td>
<td>Bills and acceptances payable</td>
<td>√</td>
<td>√</td>
<td></td>
<td></td>
</tr>
<tr>
<td>13.</td>
<td>Other liabilities</td>
<td>√</td>
<td>√</td>
<td></td>
<td></td>
</tr>
<tr>
<td>14.</td>
<td>Zakat and taxation</td>
<td>√</td>
<td>√</td>
<td></td>
<td></td>
</tr>
<tr>
<td>15.</td>
<td>Deferred taxation</td>
<td>√</td>
<td>√</td>
<td></td>
<td></td>
</tr>
<tr>
<td>16.</td>
<td>Subordinated financing</td>
<td>√</td>
<td>√</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Shareholder's Funds</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>17.</td>
<td>Share capital</td>
<td>√</td>
<td>√</td>
<td>200 Dirhams</td>
<td>2.5%</td>
</tr>
<tr>
<td>18.</td>
<td>Reserve</td>
<td>√</td>
<td>√</td>
<td>200 Dirhams</td>
<td>2.5%</td>
</tr>
</tbody>
</table>


5. **Practices of Zakat Provision on Islamic Banking Companies**

This section exposes the practices of zakat provision by Islamic banking companies in Bahrain, Saudi Arabia, United Arab Emirates, Dubai, Pakistan, Malaysia and Indonesia.
a. Bahrain Islamic Bank, Bahrain.

According to its financial report (2005, 2006) Zakat was calculated according to the provisions and principles of Islamic Shari'a. The bank distributed Zakat on:

- the statutory reserve,
- general reserve and
- retained earnings, and in addition
- the shareholder should pay his proportion of Zakat on his/her shares as stated in the financial report.

This bank also provides specific report of zakat under the heading of Consolidated Statement of Sources and Uses of Zakah and Charity Fund. This report exposes the items in the sources side such as undistributed zakah and charity funds in the beginning year plus zakah due for the bank for the year. In the use of zakah fund it reports allocations for university and school students, philanthropic society, and aid to needy families. The amount that will be paid by the Group represents the Zakah on the statutory reserve, general reserve and retained earning balances at the beginning of the year. In addition, the Bank has changed the treatment of Zakat from the year 2005. Instead of charging it to the statement of income as an expense, it is now treated as an appropriation from the retained earnings.

b. Dubai Islamic Bank, UAE

Financial report (2006) of the bank records that zakat is computed on the following basis:

- Zakat on shareholders’ equity is deducted from their dividends and is computed on their zakat pool (shareholders’ equity less paid up capital, donated land reserve plus employee’ end of service benefits)
- Zakat on profit equalisation provision is charged to this provision after it has been calculated.
- Zakat is disbursed by a committee appointed by the Board of Directors and operating as per the by-law set by the Board.
- Zakat on the paid up capital is not included in the zakat computations and is payable directly by the shareholders themselves.

In the note of Zakat Accrue there are two sources of zakat, shareholders equity and profit equalization provision.

c. Sharjah Islamic Bank, UAE.

Financial report of this bank (2006) records that “Zakat is computed in accordance with the Bank’s Articles of Association, and is approved by the Bank’s Fatwa and Shari’a Supervisory Board. Zakat is calculated at 2.577% (to account for the difference between the Gregorian and Lunar calendar) on the Bank’s reserves, retained earnings and provision for staff end of service benefits at year end and it is the Bank’s shareholders responsibility to pay the Zakat on their respective share in the Bank’s capital and the distributed cash dividends”.

d. Ar Rajhi Bank, KSA.

According to its financial report (2006), “Zakat is calculated based on the zakat rules and regulations in the Kingdom of Saudi Arabia and is considered as a liability on the shareholders to be deducted from dividends. In the case of any differences between the Corporation’s calculation and the Department of Zakat and Income Tax’s (DZIT) assessment, such differences will be charged to the general reserve.” It implies that only dividend considered as zakatable item in this company and as a business entity there is no such zakat levies applied.

e. Islamic Bank of Bangladesh, Bangladesh.
In the financial report (2005) it is mentioned that “Zakat is paid by the bank at the rate of 2.58% (instead of 2.50% as the Bank maintains its Accounts following Gregorian Year) on the closing balances of Share Premium, Statutory Reserve, General Reserve, Investment Loss Offsetting Reserve, Exchange Equalisation and Dividend Equalisation accounts. Payment of Zakat on Paid up Capital and Deposits is the responsibility of the Shareholders and Depositors respectively.”

f. Al Baraka Islamic Bank of Pakistan, Pakistan.

In the note of financial report (2005) it is mentioned that “in our opinion Zakat deductible at source under the Zakat and Ushr Ordinance, 1980 (XVIII of 1980), was deducted by the Branches and deposited in the Central Zakat Fund established under section 7 of that Ordinance”

g. Bank Islam Malaysia Berhad, Malaysia.

Following the Guidelines on Financial Reporting for Licensed Islamic Banks, in 2007 annual report zakat is recorded both in the balance sheet and income statement as well. In the note of its financial statement the zakat paid by the bank is for business zakat, however it is unclear from which zakatable items the calculated zakat be applied.

h. Bank Syariah Mandiri, Indonesia.

In the financial report the source and use of zakat funds is recorded. However, there is no mentioned about the zakatable items related to the bank as a business entity. In the source of zakat funds it records zakat from the bank, (it could be the deduction from the bank profit or zakat deducted from profit attributed to depositors) and zakat from outside the bank.

It is obvious from the above exposure that there are still wide different practices of implementing zakat at entity level among Islamic banking companies in several countries. It implies that there is an urgent need to accomplish a consensus to formulate a corporate zakat mechanism to be applied by all Islamic banking institutions across adopting countries.

6. Conclusion

Applying zakat for business is still a long way to arrive at a consensus or agreement among the stakeholders on this matter, even in the sector of Islamic banking business. Business entities such as Islamic bank business is considered as a vehicle to create value added or the wealth of individual, for which zakat levies should be applied provided all requirements be fulfilled. Basic question concerning the mixed ownership of business entities, Muslims and Non-Muslims is frequently come out, however there is a way to address this problem, either separating ownership based on each share on the business entities, or apply to all owner of business entity and treat Non-Muslims analogously as having obligation to pay jizyah.

Among other problems arising in implementing business zakat are its chargeability and its calculation, determination of zakat base and zakat eligibility of assets and liabilities. The most crucial aspect to look into is determining the zakatable items/assets, the method to select the basis of zakat and the formula of zakat calculation, within an Islamic bank entity. From practices exposed in this paper, only in a few countries, such as Bahrain, United Arab Emirates and Malaysia that business zakat in Islamic banks be implemented. In the first two countries zakatable items is clearly mentioned, i.e. the banks’ reserve, and retained earnings, while for Malaysia no specific items being explicitly mentioned but business zakat.
References


