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OBLIGATION OF COMPANIES TO PAY ZAKAT: ISSUES ARISING FROM
EFFECTS OF SEPARATE LEGAL ENTITY

By

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First, let me make it very clear that I am not challenging the ruling of the National Fatwa Committee and the Selangor Fatwa Committee. (For brevity I am using the word “ruling” to cover both the “decision” of the National Fatwa Committee and the “fatwa” of the Selangor Fatwa Committee.) I am merely trying to understand the basis or the rationale of the ruling because it involves applying one out of many religious obligations of Muslim human beings to a non-human “separate legal entity” created by law for specific non-religious purpose, which entity is neither and could never be, a “believer” (Muslim) nor a “non-believer” (non-Muslim) in the Islamic sense.

There is no issue that a free, adult, sane Muslim human being is obliged to pay zakat provided the conditions therewith are fulfilled. That has been settled since the lifetime of Prophet Muhammad s.a.w. But, when you extend a religious obligation to a legal entity created by law for specific non-religious purposes, inevitably you will be faced with new issues. I am aware that *“Muslim jurists have often said that a legal personality or entity is recognised for such entities as bayt al-mal, the waqf and mosque.”*ⁱ Even if that is so, the question remains, is the effect of such recognition the same as under the prevailing law? Did those scholars treat the *bayt al-mal*, *waqf* and mosques as a Muslim human being subject to all the religious obligations of a Muslim human being? How do you harmonize it with the principle of separate legal entity under the prevailing law?

I do not think that there is any dispute that Allah s.w.t. had sent prophets to human beings and that religion is meant for human beings (not to mention jinn) because it is human beings who could believe or disbelieve, accept or reject faith. So was Prophet Muhammad s.a.w. He did not preach to other than human beings. Human beings, like him, are the ones who could accept or reject Islam and become Muslims or non-believers. I would say, so is the Qur’an. Thus there are numerous verses that begin with “O mankind....” and numerous verses that begin with “O you who have believed.....”.

When they accept Islam then some obligations become compulsory on them, the most obvious examples are what is known as the Five Pillars of Islam consisting of the profession of faith (*shahadah*), prayers, *zakat*, fasting and *hajj*.

Thus, to take as an example, regarding fasting, the Qur’an says:

“O you who have believed, decreed upon you is fasting as it was decreed upon those before you that you may become righteous” – Al-Baqarah 183ⁱⁱ

On zakat, the following verse has been relied on by the National Fatwa Committee and the Selangor Fatwa Committee and I have no quarrel with that:

“O you who have believed, spend from the good things which you have earned and from that which We have produced for you from the earth.....” - Al-Baqarah 267ⁱⁱⁱ

Note that both are directed at “You who have believed”. Another verse rounds it up:

“Indeed, those who believe and do righteous deeds and establish prayer and give zakah will have their reward with their Lord, and there will be no fear concerning them, nor will they grieve.” - Al- Baqarah 277.^{iv}

These are obligation on Muslims, people who accept the faith or believe.

What is a “limited company” or to put it the other way, what is this principle of separate legal entity as spelled out in the celebrated judgment of the House of Lords in England in Salomon v. A. Salomon & Co. Ltd. (1897) AC 22 and now codified in the Companies Act 1965? It is a common law principle which has been given statutory recognition.

When a company is established in Malaysia under the Companies Act 1965, by operation of law, it has a separate legal entity as provided by the law for *“the purpose of fostering business development by allowing owners to invest in a venture without being personally liable in tort or contract law for the company. Thus, a shareholder or partner’s assets that are subject to recovery in a lawsuit are limited to the value of his or her ownership interest. In order to accomplish this, the law recognizes the entity as a legal person, and it is permitted to own property, enter into contracts, sue, and be sued.”^v* The law does not make a company a Muslim or a non-Muslim.

With that background, let us now refer to the relevant rulings.

First, a word about the National Fatwa Committee. It must be noted that the National Fatwa Committee is not a *fatwa* committee established under any law. It has no legal standing. Its decisions are not *“fatwas”* binding on anybody.^{vi} In the Federal Territories, the *fatwa* committee having power to issue binding *fatwas* is the Federal Territories Fatwa Committee established by the Administration of Islamic Law (Federal Territories) Act 1993 (“Federal Territories Fatwa Committee”). The Selangor Fatwa Committee is a legally constituted committee under the Administration of the Religion of Islam (State of Selangor) Enactment 2003 (Enactment No. 1 of 2003)

Both the rulings are clear that a company is obliged (*“wajib”*) to pay *zakat*.

The Selangor ruling is quite clear and consistent that the company’s obligation is to pay “on behalf” of the shareholders i.e. the shareholders’ *zakat*.

The ruling of the National Fatwa Committee is not so clear. The text of the ruling gives the impression that a company is obliged to pay its own *zakat*. However, in the reasons that follow, it suddenly uses the words “on behalf” (of the shareholders).

Both Committees give the same reasons. Both rely on the same verse of the *Qur'an*, i.e. *Surah Al-Baqarah* verse 267: “O you who have believed, spend from the good things which you have earned and from that which We have produced for you from the earth....”). Both Committees rely on the same *hadith* regarding the manner of calculating the *zakat* when the share of the individual (e.g. partners) are inseparable.

The ruling of the National Fatwa Committee further states: “As for the company shared by Muslims and non-Muslim, only the share owned by the Muslim is *zakatable*. The *zakat* is calculated based on the nett (sic) income obtained.” The Selangor ruling is to the same effect. In the case of a listed company, one wonders how that is determined.

How do the Committees arrive at their conclusions?

They assume that behind every company there are human beings (shareholders). They impute the religion of the shareholders to the company. If the shareholders are Muslims, the company is treated as a Muslim and is obliged (*wajib*) to pay *zakat*. Where the shareholders are partly Muslims and partly non-Muslim, only the Muslim¹ portion (of the net income) is liable to *zakat*.

My Comments

First, the Committees fail to make a distinction between a Muslim human being and a company when they apply the obligation to pay *zakat* to companies. *Zakat* is one of the five Pillars of Islam (*Rukun Islam*) which is an obligation (*wajib*) on individual human beings who believe in the six Pillars of Faith (*Rukun Iman*) and are, therefore, Muslims (or “believers”). The Five Pillars of Islam do not apply even to human beings who are not “believers” (Muslims) what more to mere legal entities created by (secular) law? How does a company make the profession of faith (*shahadah*), pray, fast and perform the *hajj*? In so doing, the Committees give a different treatment to *zakat* compared to the other obligations. On what basis? For the purpose of *zakat* alone, they treat a company like a human being. They rely on the *Qur'anic* verse referred to earlier which is clearly applicable only to human beings who are able to believe or not to believe. Companies are unable to believe or disbelieve in Islam or to choose to be a Muslim or not.

Secondly, the Committees fail to make a distinction between companies and a sole proprietorship or a partnership. In the case of a sole proprietorship or a partnership, it is the Muslim human being owner or partner, as the case may be, who is obliged to pay *zakat* from his business activities whether in the form of a sole proprietorship or partnership. The principle of separate legal entity does not apply to sole proprietorship and partnership.

Thirdly, the Committees impute the religion of the shareholders to the company: if they are Muslims, the company is a Muslim having the same obligation regarding

¹ Corrected on 01 03 2016, originally “non-Muslim”.

zakat. That, in the first place, is in breach of the principle of separate legal entity. Furthermore, how do we impute a religion to a non-human being, recognized as a legal entity by law (common law and statutory law) only for specific purpose e.g. limited liability in debt, right to own property, right to sue and be sued etc? Why only for *zakat* and on what basis? If that could be done, then, through the same process, a company could also be identified according to race and gender, which is absurd.

Fourthly, even if you could impute religion to a company (in my view, no), some big shareholders may not be individual human beings. They could be other companies including such corporations like Tabung Haji, Employees Provident Fund or even Bank Negara. (Is Tabung Haji a Muslim even though it is a "*haji*"?). There could be many layers of such shareholders which themselves have no religion to be imputed to the first-mentioned company.

Whose *zakat* is the company obliged to pay?

If the obligation of the company is to pay its own *zakat*, the issues raised in earlier paragraphs are pertinent i.e. is a company an independent, adult, sane, Muslim person capable of believing and disbelieving and with obligation to perform the five pillar of Islam as well as other injunctions besides avoiding what is prohibited?

If the obligation is to pay the shareholders' *zakat*, we are placing a higher religious burden on a company than even on a Muslim human being by, first, treating it as a Muslim human being and, secondly, by placing on it the obligation to pay somebody else's *zakat*. Even a Muslim human being does not have to pay another Muslim human being's *zakat*.

It is trite law that whatever is earned by a company belongs to the company. The company may or may not declare dividend. If it does, only when the shareholders receive their dividend that they, individually, become obliged to pay *zakat* if the conditions for *zakat* are fulfilled, for example, the amount is sufficient to attract the obligation to pay *zakat*. If until then, the shareholders are themselves not obliged to pay *zakat* or they are not obliged to pay *zakat* at all, why should the company be obliged to pay their *zakat*?

From whose funds the company pays the shareholder's *zakat*? Obviously it is from the company's own funds. Is that proper? Is that not quite similar to a company settling the shareholders' private debts?

Under the present arrangement, the company is given tax rebate for the *zakat* it pays. If it pays its own *zakat*, there is no issue, from the point of view of tax law. But, if the company pays the *zakat* of the shareholders, is it entitled to a rebate for paying the *zakat* of the shareholders? Is not a taxpayer, in law, only entitled to a rebate for his own *zakat* that he pays, not on other people's *zakat* even if he volunteers to pay.

The Committees fail to take into account constitutional issues. First, *zakat* is a State matter while companies are a Federal matter. A State Fatwa Committee may give a ruling on the obligation of companies to pay *zakat* but the ruling is unenforceable on companies, even if it gazetted. This is because companies are not within the State jurisdiction. Therefore, any State law that makes it an obligation for companies to pay *zakat* is unconstitutional. Secondly, the constitution only allows *zakat* to be collected from “*persons professing the religion of Islam*”. Companies have no religion. To make use of federal law to collect *zakat* from companies is equally unconstitutional for the same reasons.

Conclusion

1. *Zakat* is a religious obligation of a Muslim human being, just like prayer, fasting and *haj*. Whatever *zakat* that a Muslim human being is obliged (*wajib*) to pay, from whatever source subject to *zakat*, is the obligation of the Muslim human being to pay and should be collected from him.
2. A company has no religion. It is neither a Muslim nor a *kufur*. A company established under the Companies' Act 1965 is recognized in law as having an identity separate from the shareholders in regard to liability to pay debts, the right to own property, the right to sue and be sued etc. There is no basis for imputing the religion of the shareholders to a company and only for the purpose of paying *zakat*. It is misplaced to say that a company is obliged (*wajib*) to pay *zakat* like a Muslim human being. There is also no basis for treating *zakat* differently from the other obligations like prayer, fasting and *hajj*.
3. In Malaysia, a ruling that a company is obliged to pay *zakat* though gazetted, is not enforceable on companies because, first, under the constitution, a company is not a State matter. Secondly, a company is not within the jurisdiction of the Shariah Court. Thirdly, any State law imposing *zakat* on a company is void because under the constitution, *zakat* could only be made obligatory on “*persons professing the religion of Islam*.” Companies are not.
4. At the very least, it is improper for a company to use its own funds to settle the *zakat* of the shareholders. It is quite similar to requiring a company to use its own funds to settle the shareholders' private bills.
5. I doubt that a company is entitled to a tax rebate for paying the *zakat* of the shareholders.

I think the Inland Revenue Board of Malaysia should start thinking whether it is giving tax rebate to the right taxpayers.

That, in summary, is my comment. If you would like to read a fuller discussion, please visit my website. There is an article bearing the same title, my first article on the subject,

which I had uploaded on my website since 18th July 2012 with the hope that someone would write a response to explain the issues raised therein. Even though 500 people have visited it, nobody has done it so far. Instead I received emails from academicians, both locals and foreigners based in Malaysia, saying that they shared the same view. One of them even urged me “to use (my) influence” to have a seminar attended by experts in sharia, law and others to re-discuss the issue.

I do hope that some organizations will pick up the idea of organizing a bigger workshop or seminar to revisit the issue. This is not just a matter of academic interest. It has very wide implications and involves hundreds of millions of Ringgit every year. In the meantime, let me pose some questions for you to think. (These questions are premised on the basis that a company pays the shareholders' zakat on their behalf.)

1. Suppose a shareholder of a company were to challenge that the company has no right to pay his zakat on his behalf when he had not even received the dividend and did not know how much he would receive, if at all and, therefore, he was not liable to zakat yet, what would the response be?
2. Suppose, a shareholder of a company were to challenge the Inland Revenue Board for giving tax rebate to a company for purportedly paying his zakat, what would the response be?
3. Suppose a shareholder of a company were to complain that the company had improperly used its funds to settle personal debts of the shareholders, what would the response be?
4. Suppose the Majlis Agama Islam of the States were to claim that zakat of the shareholders living in their respective States should be paid to the respective Majlis Agama Islam and not to The Majlis Agama Islam of Wilayah Persekutuan, where the registered office of the company is situated, what would the response be?

I think that should be enough for the time being.

Thank you.

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NOTES

ⁱ Professor Dr Mohammad Hashim Kamali, in a personal correspondence.

ii

يَأْتِيهَا الَّذِينَ ءَامَنُوا كُنِبَ عَلَيْكُمْ الصِّيَامُ كَمَا كُنِبَ عَلَى
الَّذِينَ مِنْ قَبْلِكُمْ لَعَلَّكُمْ تَتَّقُونَ ﴿١٨٣﴾

O you who have believed, decreed upon you is fasting as it was decreed upon those before you that you may become righteous – Al-Baqarah 183

iii

يَأْتِيهَا الَّذِينَ ءَامَنُوا أَنفَقُوا مِنْ طَيِّبَاتِ مَا كَسَبْتُمْ وَمِمَّا
أَخْرَجْنَا لَكُمْ مِنَ الْأَرْضِ ۗ وَلَا تَيَمَّمُوا الْخَبِيثَ مِنْهُ تُنْفِقُونَ وَلَسْتُمْ
بِءَاخِذِيهِ إِلَّا أَنْ تُغْمِضُوا فِيهِ ۗ وَاعْلَمُوا أَنَّ اللَّهَ غَفِيرٌ حَمِيدٌ ﴿٢٦٧﴾

O you who have believed, spend from the good things which you have earned and from that which We have produced for you from the earth. And do not aim toward the defective therefrom, spending [from that] while you would not take it [yourself] except with closed eyes. And know that Allah is Free of need and Praiseworthy. - Al-Baqarah 267

iv

إِنَّ الَّذِينَ ءَامَنُوا وَعَمِلُوا الصَّالِحَاتِ وَأَقَامُوا الصَّلَاةَ وَءَاتَوْا
الزَّكَاةَ لَهُمْ أَجْرُهُمْ عِنْدَ رَبِّهِمْ وَلَا خَوْفٌ عَلَيْهِمْ وَلَا هُمْ
يَحْزَنُونَ ﴿٢٧٧﴾

Indeed, those who believe and do righteous deeds and establish prayer and give zakah will have their reward with their Lord, and there will be no fear concerning them, nor will they grieve. - Al- Baqarah 277

^v Julio C Colon, a US Attorney quoted in “Obligations of companies to pay zakat: issues arising from effects of separate legal entity by Tun Abdul Hamid Mohamad (2012) LR 481; www.tunabdulhamid.my

^{vi} I have in the *Muzakarah Ahli-Ahli Majlis Penasihat Syari'ah Institusi Kewangan Di Malaysia Kali Ke-5* on 17-19 June 2009 in a paper entitled “*Perbankan Islam dan Takaful: Forum Untuk Penyelesaian Isu Undang-Undang Dan Hukum Syarak*” made a suggestion that the Committee could in fact be legalised with limited jurisdiction. – see <http://www.tunabdulhamid.my>. However, no one picked up the idea.