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## ARTICLES

### Obligation of Companies to Pay Zakat: Issues Arising from Effects of Separate Legal Entity

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In mid-1970s, when I was a Senior Federal Counsel in the Department of Inland Revenue, I attended a conference held to discuss the suggestion that zakat be collected by the Department of Inland Revenue. During the discussion, the issue regarding the obligation of companies to pay zakat arose. The Syariah scholars were unanimous that companies were obliged (*wajib*) to pay zakat. However, as no one offered any reason or explanation for the view, I asked, amongst other things: Are companies human beings with a soul, able to become Muslims or apostates? How do they believe in the six Pillars of Faith (*Rukun Iman*)? If they are bound by the Pillars of Islam (*Rukun Islam*), why only zakat?

During the coffee break, I met a syariah scholar (I did not know him personally) and he said to me, "Behind every company there are human beings?" I replied, "Then the human beings should to pay the zakat".

Over the years, I raised the issue a few times, hoping to get a clarification. On one occasion, a syariah scholar told me that the company pays on behalf of the shareholders. On another occasion, when I raised it at a meeting of syariah scholars, one member interjected that as the matter had been decided by the *Muzakarah* (Conference) of the Fatwa Committee National Council of Islamic Religious Affairs Malaysia ("the National Fatwa Committee"), the issue should not be raised again.

Now, having read the decision of the National Fatwa Committee, the *fatwa* issued by the Selangor Fatwa Committee and a paper by ISRA Researchers, I feel compelled to raise some issues that do not appear to have been sufficiently considered by the Committees or the Syariah scholars in arriving at their decision or opinion.<sup>1</sup>

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1 Fearing that I might be disturbing the hornets' nest due to my misunderstanding or ignorance of the Syariah, I showed my draft to my friends who are lawyers, Syariah scholars, academicians, bankers and regulators (some of them are of international standing) with a specific request: "Please read and tell me where I am wrong". Instead of getting replies

Before going any further let me clarify a few things. First, I am not a syariah scholar and I am not trying to give my decision or opinion, more so a “*fatwa*” on the issue. I am merely trying to understand the decision of the committees, point out certain issues arising therefrom which do not appear to have been properly advised and sufficiently considered and point out where, in my view, the committees could possibly have misdirected or non-directed themselves. Finally, I would try to list out the issues that need to be further studied, advised and deliberated preferably by a bigger conference consisting of experts in all relevant disciplines and not Syariah scholars alone and make a fresh decision or, at least, clarify it and give more comprehensive reasons to support the existing decision. As I have said many times, nowadays, the difficulty is not to find the relevant verses of the *Qur’an* or the *Hadith* on a particular issue. The difficulty is to understand the facts, including the applicable law of the land and to apply the Syariah principles. Syariah scholars, like experts in other disciplines, could not claim to know everything any more.

Secondly, I am not questioning any Syariah principle. I accept that a Muslim is obliged to pay zakat if the preconditions are met. However, I will analyse the application of the Syariah position on zakat to companies which, in law, have a separate legal identity. This principle of separate legal entity is a common law principle, later legislated by Malaysian Parliament into the Companies Act 1965.

Thirdly, let me make it clear that I am not concerned about the result: whether a company is obliged to pay zakat or not. I am completely neutral in that respect. The judge in me is still present. I am only concerned about the reasons because I am at a loss in trying to understand the decision and the *fatwa* and the reasons thereto.

In this paper, I will be referring mainly to:

1. The decision of the National Fatwa Committee held on December 9, 1992 titled “*Zakat Ke Atas Syarikat*” (Zakat On Companies).<sup>2</sup>
2. The decision of the National Fatwa Committee on August 16, 2001 titled “*Zakat On Shari’ah Compliance Banks and Business Companies Where the Parent Companies are Owned by Non Muslims*”.<sup>3</sup>

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that I am “wrong here, wrong there and wrong everywhere”, they advised me to send the paper for publication hoping that it will lead to more research and discussion on the issue, as they themselves are perplexed by it. They even urged me to use my ‘influence’ to get the issue reopened and discussed at a bigger forum consisting of Syariah scholars, lawyers, bankers, regulators, academicians and others. In a sense, my fear has happened: I have really disturbed the hornets’ nest.

2 Published on *Portal Rasmi Fatwa Malaysia* ([www.e-fatwa.gov.my](http://www.e-fatwa.gov.my)) under “e-Fatwa” entitled “*Zakat Ke Atas Syarikat*”.

3 Ibid.

3. The decision of the National Fatwa Committee dated May 10, 2001 titled "*Zakat Ke Atas Syarikat Yang Dimiliki Oleh Berbagai Jenis Pemegang Saham Yang Bercampur Muslim Dan Non Muslim*".<sup>4</sup> (Zakat on Companies Owned by Different Types of Owners Mixed Between Muslims and Non-Muslims.)
4. Fatwa (Ruling) of the Fatwa Committee of the State of Selangor ("Selangor Fatwa Committee") dated July 24, 2001 titled "*Fatwa Tentang Zakat Ke Atas Syarikat Yang Dimiliki Oleh Pelbagai Jenis Pemegang Saham Yang Bercampur Muslim dan Non Muslim*".<sup>5</sup> (Ruling (Fatwa) on Zakat on Companies Owned by Different Types of Owners Mixed Between Muslims and Non-Muslims.)
5. A paper prepared by International Research Academy for Islamic Finance ("ISRA Paper") for the Workshop on Zakat for Islamic Financial Institutions held on May 3, 2011 titled "Legal Entity and Zakah Obligations".<sup>6</sup>

In this paper, I am using the word "companies" (*syarikat*) to mean companies incorporated under the Companies Act 1965. The most important point to note is that the companies have a separate legal entity from the shareholders. I am using the Malaysian spelling of "zakat". However, when I am quoting from the papers written by other authors, I will use the spelling that they use e.g. "zakah" and "zakaat". In respect of companies, I am using the word "owners" and "shareholders" interchangeably.

With those points cleared, let us look at the opinions of the National Fatwa Committee. (I shall reproduce the English version of the opinion and give my own translation of the reasoning where the English translation is not provided.)

### **Zakat on company**

*Date of decision: December 9, 1992*

#### **Decision**

The 31st Muzakarah (Conference) of the Fatwa Committee National Council of Islamic Religious Affairs Malaysia held on 9th December 1992 has discussed zakat on company. The Conference has decided that a business company is obliged to pay zakat ("*syarikat perniagaan diwajibkan zakat*") when it fulfils these conditions:

- The company is owned by Muslims

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4 Ibid. I am giving a literal translation. The language reflects the influence of the Syariah principle of "*khultah*" which the Committee is relying on.

5 [www.e-fatwa.gov.my/fatwa-negeri](http://www.e-fatwa.gov.my/fatwa-negeri).

6 Paper prepared for Workshop on Zakat for Islamic Financial Institutions, Lanai Kijang Bank Negara Malaysia, May 3, 2011

- The company is owned by free Muslims
- Complete ownership
- The amount of the wealth reaches the minimum zakatable [*sic*] limit (nisab)
- The wealth has been possessed for one lunar year (354.3 days)
- The zakat rate on company is 2.5%

As for the company shared by Muslims and non-Muslims, only the share owned by the Muslims is zakatable. The zakat is calculated based on the nett income obtained.”

(To keep this paper short, I have summarised in English the “*Keterangan/Hujah*” (evidence/arguments) given in support of the decision.)

1. The committee had directed the Islamic Affairs Division (of the Prime Minister’s Department or JAKIM) to prepare a paper entitled Zakat on companies and to present it to the Conference with a view to obtaining a decision on the Syariah position as well as the rate payable.
2. The decision is required by the Department of Inland Revenue (JHDN) to enable the department to give tax rebate for the amount paid by the companies to the State Islamic Religious Council or Department in the same way as it is given to individuals who pay zakat. This is to avoid companies which have paid zakat having to pay tax as well.

(The following is my translation of the “*Hujah dan Dalil*” (Argument and Authority) into English, trying to keep it as close as possible to the Malay text.):

The establishment of companies (*syarikat*) is governed by the Companies Act 1965. The companies incorporated under the Act may be divided into three types:

- (a) a company limited by shares;
- (b) *an unlimited company; and*
- (c) *a company (limited—added) by guarantee.*

Scholars (Ulamas) had been unanimous that trading companies are obliged (*wajib*) to pay zakat when the following conditions regarding the obligation to pay trading zakat are met:

... (Omitted as they are a repetition of the first five of the six points reproduced above).

The opinion is based on what Allah s.w.t. has revealed in Surah Al-Baqarah, verse number 267:

*Maksudnya:*

*Wahai orang yang beriman! belanjakanlah (pada jalan Allah) sebahagian daripada hasil usaha kamu yang baik-baik, dan sebahagian dari apa yang kami keluarkan dari bumi untuk kamu ...*

(“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 ...” — English translation according to *Sahih International* — my addition).

Scholars have interpreted the word (which word? Most likely “which you have earned” — added) to mean all kinds of permissible endeavours done by human beings whether in the form of trading, industry, agriculture and the like, whether the endeavour is done individually or company. In a Hadith, the Prophet p.b.u.h. is reported to have said:

*Maksudnya:*

*... tidak terhimpun antara yang terpisah dan tidak terpisah antara yang terhimpun kerana takut bersedekah (zakat), dan orang-orang yang menternak binatangnya hendaklah berdamai antara keduanya dengan berdasarkan persamaan ...*

(... what is separated is not mixed and what is mixed is not separated for fear of paying zakat, and people who rear animals should agree among themselves on the basis of equality... — my own English translation).

Based on this *Hadith* it may be concluded that individuals who are in a company or group are considered as one without being separated from each other.

Whenever a company is established with the intention of trading whether it is a service company, law firm, hotel, arbitration, medical, recreation, exploration and so on, the company is considered as a trading company that is obliged to pay trading zakat. The rate of the zakat is 2.5% of the net income

Therefore, it is the obligation of the company to pay zakat on behalf of the owners and if the company does not pay the zakat, then the owners must pay the zakat themselves (*secara persendirian*). In the case of a company jointly owned by Muslims and non-Muslims, the zakat shall only be paid based on the shares owned by Muslims only.

Source: Collection of decisions of the Conference of the National Fatwa Committee on issues of Mu’amalat (2009).

**Zakat on shariah compliance banks and business companies where the parent companies are owned by non-Muslims**

*Date of decision: August 16, 2001*

**Decision**

The Special Muzakarah (Conference) of the Fatwa Committee National Council of Islamic Religious Affairs Malaysia held on 16th August 2001 has

discussed zakat on Shariah-compliance-banks and business companies where the parent companies owned by non Muslims. The Committee has decided that all Islamic banks and counters that operate on Shariah basis are obliged to pay zakat although their parent companies are owned by non-Muslims.

### **Zakat on business companies owned by Muslim and non-Muslim shareholders**

*Date of decision: May 10, 2001*

#### **Decision**

The 50th Muzakarah (Conference) of the Fatwa Committee National Council of Islamic Religious Affairs Malaysia held on 10th May 2001 has discussed zakat on business companies owned by Muslim and non Muslim shareholders. The Conference has decided that zakat is only imposed on the shares owned by the Muslim shareholders.

### **Zakat on companies owned by different types of owners mixed between Muslims and non-Muslims**

I shall now selectively reproduce parts of the Fatwa of the Selangor Fatwa Committee dated July 24, 2001 (As it is wholly in Malay, I have translated the parts which I am reproducing):

*1. Diwajibkan zakat bahagian Muslim sahaja bagi syarikat yang bercampur antara pemegang saham muslim dan non muslim.*

(“1. Zakat is obligatory only on the shares of Muslims in a company whose shareholders are mixed between Muslim and non-Muslims”.)

(I am purposely giving a literal translation to reflect the influence of the Syariah principle of “*khultah*” (“*bercampur/mixed*” in the minds of the scholars.)

The reasons given in support of the ruling are the same as those given by the National Committee, including the verse of the Qur’an and the Hadith relied on with some addition. As has been observed, they refer to human beings.

Paragraph (e) of the *fatwa* says:

Scholars (Ulamas) are unanimous that zakat is obligatory (wajib) on individual Muslims (individu Muslim) ... (who qualify the oft-repeated conditions).

Under “Keterangan/Hujah” (evidence/argument):

Para ulama’ ... telah bersepakat bahawa pemilik syarikat-syarikat perniagaan adalah wajib mengeluarkan zakat ...

("Scholars ... are unanimous that owners of trading companies are obliged to pay zakat ...).

### **Legal Entity and zakat obligations**

We shall now take a quick look at the ISRA Paper. It was prepared by five academicians and researchers from the International Islamic University (IIUM). I shall selectively reproduce the parts that I consider necessary for our present discussion.

The paper gives the Syariah definition of zakat as follows:

The technical definition of zakah is: an act of worship performed to draw closer to Allah by extracting an obligatory right from certain kinds of wealth and giving it to specified groups at a specified time, in accord with specific conditions.

On the legal basis for zakat:

... Zakah is one of the five pillars of Islam and is obligatory upon every Muslim for whom its requisite conditions are fulfilled. ... It is mentioned along with salah in more than 80 passages of the Qur'an; for example, "Establish prayer and pay zakah" (al-Qur'an, 2:43); Cf. 98:5 ...

... Among the many passages in which zakah is mentioned in the Qur'an are the following: "Establish prayer and pay zakah, and whatsoever good you send before you for your souls, you will find it with Allah". Also: "And they were ordered nothing else than to serve Allah, keeping religion pure for Him, to be by nature upright, and to establish prayer and to pay zakah. That is true religion".

... The Sunnah has a multitude of texts confirming the Qur'an's orders regarding the obligation to pay zakah; among them, the following:

... 'Abd Allah ibn 'Umar quoted the Prophet (r) as saying, "Islam is founded on five [pillars]: to bear witness that none has the right to be worshipped except Allah and that Muhammad is the Messenger of Allah; to establish salah, pay zakah, make Pilgrimage [to Makkah], and fast in Ramadan".

...

#### *3-4 The Shari'ah Ruling on Paying Zakah*

Shari'ah jurists all agree that for a free, sane, adult Muslim who knows that zakah is an obligation, whether male or female, zakah is obligatory on his/her wealth if it reaches the nisab, if the owner has the ability to pay and the necessary conditions are fulfilled on the wealth.

#### *4-1 Zakah Obligations on Entirely Privately Owned Islamic financial institutions*

There is no difference of opinion that it is obligatory for full-fledged Islamic financial institutions that are entirely privately owned to pay

zakah. The only controversy is with regard to who is legally obligated to make the payment in the first place. The controversy on this issue has led to the emergence of three approaches:

The first approach gives full consideration to the concept of legal entity, recognizes it as having complete legal capacity (*ahliyyah*), and holds that the corporation is obligated to pay zakah for itself. No attention is paid to the *nisab* of the individual shareholders once the wealth of the corporation reaches the *nisab*. The corporation pays it based upon the nature of its activity (commercial or investment) and without giving consideration to the intentions of its shareholders ...

The second approach recognises that a legal entity has *ahliyyat al-wujoob* (the capacity for acquisition of rights) but not *ahliyyat al-adaa'* (the capacity for performance of duties) and that this *ahliyyat al-wujoob* is effective to the extent that is appropriate for it ... they took the view that the shareholders have the original obligation to pay the zakah, but they may assign the bank to act as their representative and pay it on their behalf. This view was adopted by the International Islamic Fiqh Academy in its resolution No. 28(3/4), Shaykh al-Darir, Wahbah al-Zuhayli, al-Buti and others.

The third approach: The payment of zakah is obligatory upon the corporation or financial institution, and its legal entity is given consideration, if the state's legal system imposes the obligation to pay zakah upon financial institutions. This is the view of al-Mawdudi, al-Qaradawi, and al-Shubayli.

#### *4-3 Zakah Obligations on an Islamic Financial Institution Owned Completely or Partially by Non-Muslims*

... Muslim jurists agree that the Shari'ah texts do not impose in principle the obligation to pay zakah on non-Muslims in this world.

##### *Research Team Opinion*

The research team has concluded that zakah should be taken from Islamic financial institutions owned by non-Muslims when they operate in a Muslim land. This view is based upon the following evidence:

The concept of legal entity, by which the Islamic financial institution is dealt with as an entity independent of the individuals who form it. Therefore, as long as it operates in a Muslim state under an Islamic label, zakah is due upon it, without consideration of the religion of those individuals who comprise it, and without consideration of whether the wealth of its individuals reaches the *nisab*.

- The difference of opinion among scholars of the Shari'ah regarding the validity of the concept of legal entity has produced two schools of thought. One school rejects the possibility that a legal entity has the capacity to undertake obligations, although this school does not reject legal recognition of its existence. The other school fully recognizes



the concept of legal entity and accords it complete capacity to earn rights and undertake obligations. The research team has chosen the second opinion due to the persuasiveness of the evidence for it.

- There is no difference of opinion among scholars that corporations and Islamic financial institutions that are entirely privately owned must pay zakah. The only difference is over who is originally required to pay it.
- Muslim jurists agree that the Shari'ah texts do not impose the obligation to pay zakah on non-Muslims in this world. However, they made an exception for 'ushur (excise tax) taken from non-Muslims merchants living inside or outside an Islamic state when they do business in a Muslim country other than their own country. They also made an exception for the Christian Arab tribe of Banu Taghlib, from whom "zakah" was taken at a doubled rate. The research team favors the view that zakah should be taken from Islamic financial institutions owned by non-Muslims when they operate in a Muslim land.

We shall now take a quick look at the paper issued by the Majlisul Ulama of South Africa under the title *The Concept of Limited Liability—Untenable in Shariah*<sup>7</sup> to refute the view expressed by Taqi Usmani in a book entitled *The Principles of Limited Liability*. I am only reproducing a short passage from the sub-heading "What is Zakaat?" and "What is Khultah?" in which the paper repeatedly stressed that zakat is payable by a Muslim human being. Thus:

Everyone knows that Zakaat is one of the Arkaan (Fundamentals) of Islam. The obligation of this Fardh injunction devolves on Muslims—Muslim human beings, not on kuffaar, least of all on inanimate objects such as wheat and rice.

Returning to the decisions of the National Fatwa Committee, first, it must be noted that the National Fatwa Committee is not a fatwa committee established under any law. It has no legal standing.<sup>8</sup> Its decisions are not "fatwas" binding on anybody. 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").

It is clear that the ruling of the National Fatwa Committee under discussion refers to companies incorporated under the Companies Act 1965. It specifically

7 <http://books.themajlis.net/book/print/251>

8 I have in the *Muzakarah Ahli-Ahli Majlis Penasihat Syari'ah Institusi Kewangan Di Malaysia Kali Ke-5* on June 17–19, 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 [www.tunabdulhamid.my](http://www.tunabdulhamid.my). However, no one has picked up the idea.

mentions the Act. It is clear that the obligation is the obligation of the company, not that of the “owners” or shareholders. It looks as if the committee is giving full recognition to the principle of separate legal entity. However, when one looks at the “conditions” given (i.e. “1. *The company is owned by Muslims*, 2. *The company is owned by free Muslims*”, we see that, like the Syariah scholar I met three decades earlier, the Committee falls back on “the human beings behind the company” for justification.

Whose zakat? To me, logically it has to be the company’s own zakat because nobody, not even a human being, is obliged to pay another person’s zakat, just as no one is obliged to pray or to fast on behalf of someone else.

We shall now look at the “Argument and Authority”. It starts off with “Scholars (Ulamas) *had been unanimous that trading companies are obliged (wajib) to pay zakat ...*”. The opinion is based on the Quranic verse quoted. My question is: Does the phrase “O. You who have believed ...” include other than human beings? (I am putting aside angels and jinns (genie) as we are not concerned about them in this discussion.) I also do not see how the *Hadith* quoted as the authority assists us in arriving at the conclusion that a company, as a separate legal entity, is obliged to pay its own zakat. That *Hadith*, to me, talks as to how the zakat is to be calculated when the “wealth” is inseparable.

Then the “Argument and Authority” repeats the proposition, “... *the company is considered as a trading company that is obliged to pay trading zakat*”. Still, the impression it gives is that the company is obliged to pay its own zakat. And, always bear in mind the reason why the decision was sought: to enable the Department of Inland Revenue to give tax rebate to the companies that had paid zakat in the same way as it is given to individuals who pay zakat in order to avoid the companies which have paid zakat having to pay tax as well! So, it could only mean one thing: a company is obliged to pay its own zakat.

However, the following paragraph seems to say the opposite: “Therefore, it is the obligation of the company to pay *zakat on behalf of the owners* and if the company does not pay the zakat, then the owners must pay the zakat themselves (*secara persendirian*)”. (Emphasis added)

Up to this point that the National Committee appears to have confused two things:

1. human beings (Muslims) and a company as a separate legal entity;
2. whether the company is obliged to pay its own zakat or the zakat of (and on behalf of) the “owners” or shareholders.

(Like the National Fatwa Committee, the Selangor Fatwa Committee also talks of the company’s obligation to pay zakat. However, the Selangor committee is quite clear and consistent in that it is referring to the “owners’” or the “individual Muslims’” zakat for which the company is obliged to pay on

behalf. Except for that “difference”, the effects of the Selangor *fatwa* and the Federal Territory decision are the same and my comments on the latter are equally applicable to the former.

Since the Selangor *fatwa* has been gazetted, everyone would think that it is now a binding *fatwa* having the force of law on companies. Let me remind everyone that, in so far as it is meant to place a legal obligation on companies to pay zakat, in my view, it is unconstitutional. Obligation to pay zakat, even a person’s own zakat, under the Constitution, is the obligation of “persons professing the religion of Islam”.<sup>9</sup> A company is clearly not. To place a legal obligation on a company to pay zakat of the owners or the shareholders is to impose an even higher religious obligation on a company than on human beings. Furthermore, companies are outside the jurisdiction of State Legislative Assembly and outside the jurisdiction of the Syariah Courts. In brief, that *fatwa*, though gazetted, is unenforceable on companies!

The National Fatwa Committee makes no distinction between companies and other forms of trading organisations not incorporated under the Act e.g. partnership. All are treated as “trading companies” (*syarikat perniagaan*). (In fact, all the decisions, *fatwas* on the National Fatwa Committee, the Selangor Fatwa Committee, ISRA Paper and all traditional Syariah scholars seem to treat companies that way.) The examples given in the decision dated December 9, 1992 refer to the different types of business activities, not to the types of organisation. The three types of companies mentioned in the same decision are the types of companies which could be incorporated under the Act. The Committees make no mention at all about the principle of a separate legal entity and what effects it has on the companies in considering their obligation to pay zakat.

In Malaysia, all companies incorporated under the Companies Act have a separate legal entity from their shareholders. This principle is of common law origin established by the unanimous decision of the House of Lords in England in *Salomon v A Salomon & Co Ltd* [1897] AC 22<sup>10</sup> but, later adopted in the Companies Act 1965 and is the law in Malaysia. Section 16(5) of the Act says:

A company shall be regarded as a body corporate, capable of exercising all the functions of an incorporated company.

<sup>9</sup> Ninth Schedule, List II, Federal Constitution.

<sup>10</sup> *Salomon v A Salomon & Co Ltd* [1897] AC 22, HL, is a landmark UK company law case. The effect of the Lords’ unanimous ruling was to uphold firmly the doctrine of corporate personality, as set out in the Companies Act 1862, so that creditors of an insolvent company could not sue the company’s shareholders to pay up outstanding debts.

The companies under discussion are incorporated under the Act and bear that characteristic. The debate amongst the 'Syariah scholars' whether the principle is tenable or not in Syariah is not relevant at all in this exercise. The law has settled it whatever view one takes. The most important effect arising from this principle is that, since a company has a separate legal entity, whether it is obliged to pay its own zakat. To me, the answer should depend on whether the company satisfies the five conditions similar to those applicable to human beings, i.e:

- a. the company is a Muslim;
- b. the company is a free person (not a slave);
- c. the company has complete ownership of the "wealth";
- d. the amount of the "wealth" reaches the minimum zakatable [sic] limit (nisab);
- e. the "wealth" has been in possession of the company for one lunar year (354.3 days).

While (c), (d) and (e) may be satisfied, (b) is not applicable and can never be satisfied. Regarding a, the questions that I posed three and a half decades ago remain valid and unanswered. No argument is needed that zakat is obligatory only on Muslim human beings. The passages that I have quoted above from the papers all agree on this point. Is a company then a Muslim human being? I do not think anyone would say it is. Again no argument is needed. On what ground then those who say, a company is obliged to pay its own zakat, say so?

The National Committee did not address the issue that way. It merely looked at the "owners". If the "owners" are Muslims, the company is obliged to pay zakat. If all the "owners" are non-Muslims, the company is not obliged to pay zakat. If some of the "owners" are Muslims, only the income attributable to the shareholding of the Muslim shareholders is subject to zakat.

The question is, can you attribute the religion of the shareholders ("owners") of a company to the company? To my mind, to do so would run counter to the principle of separate legal entity. We are indeed blowing hot and cold. On the one hand, we say that a company has a separate legal entity from the shareholders. Yet, in the same breath, we attribute the religion of the shareholders to the company, but only for the purpose of paying zakat! I would even venture further to say that to attribute religion to other than human beings is contrary to the concept of religion (faith) itself. The essence of faith is belief (*Iman*) which a non-human being, not even the most intelligent orang utan or a robot, is capable of. After all, was the Al-Qur'an and all the Prophets not sent for human beings? Furthermore, why do so only for the purpose of zakat, even then not including *fitrah*?

The statement that “Behind every company there are human beings” is ever present in Syariah scholars’ minds. That is true in the case of trading organisations like partnerships. But, does it not make a difference in the case of companies with separate legal entity? Is it correct to attribute the religion of the shareholders to the company? In this regard, it must be remembered that it is not true that the shareholders of a company are always human beings. There are layers on corporate shareholders, including the Treasury, Ministry of Finance, Inc. and Bank Negara Malaysia. They themselves have no religion. How do you then attribute their “religion” to the company?

The above discussion relates to the view that a company is obliged to pay its own zakat. Unfortunately, as has been pointed out, the decision of the National Fatwa Committee is not clear on this issue. Having given the impression that the company is obliged to pay its own zakat, it speaks of the company paying zakat on behalf of the owners. In other words, the company pays the zakat of the shareholders on behalf of the shareholders who are Muslims based on the percentage of shares held by the Muslim shareholders.

Actually, once you accept that the company, as a legal entity, is not obliged to pay its own zakat, the question whether it should pay zakat, as a religious obligation, on behalf of the shareholders falls by itself. It is not obligatory on anybody, not even human beings, to pay other people’s zakat. Zakat is a religious obligation by the fact of being a Muslim in the first place, in the same category as prayers, fasting and hajj. To say that a company is obliged to pay zakat on behalf of the shareholders involves two stages:

1. To treat it as an adult, sane and free Muslim to make it “similar” to an adult, sane and free Muslim human being and imposing the obligation to pay zakat on it.
2. To impose on it an obligation to pay the zakat of other people (the shareholders), a higher obligation than that of human beings.

Furthermore, if a company is obliged to pay the zakat of its shareholders, it should also be obliged to pay all the debts of the shareholders, which is also an obligation in Syariah.

We must always bear in mind that we are talking about a “religious obligation” and not a requirement of law, secular law. The law may impose such obligation whether it is in compliance with Syariah or not, subject to the limitations imposed by the Constitution.

Now, let us assume that a company, under the Syariah, is obliged to pay the zakat of the shareholders. My questions then are: with whose income is the company paying zakat? Income received by the company, until it is distributed by the company to the shareholders in the form of dividend, belongs to the company. The shareholders have not received their shares yet and they are not obliged to pay zakat yet. If the company does not declare dividend that year,

the shareholders do not receive any income at all that year. Why should they be paying zakat? Furthermore, if the company pays zakat of the shareholders, why should the tax rebate be given to the company? A taxpayer is only entitled to a tax rebate for his zakat which he pays, not of other people's zakat, even if he volunteers to pay. Lastly, if the corporate veil could be lifted to make the company pay the zakat of the shareholders why can't it also be lifted to make the company pay the shareholder's debts or vice versa?<sup>11</sup>

So, whichever way you understand the decision to mean, whether the company is obliged to pay its own zakat or the zakat of the shareholders on behalf of the shareholders, there are serious questions to be answered.

I shall now turn to the points made by the ISRA Research Team. First, regarding privately owned companies. The Team concluded:

There is no difference of opinion that it is obligatory for full-fledged Islamic financial institutions that are entirely privately owned to pay zakah. The only controversy is with regard to who is legally obligated to make the payment in the first place.

Then it went on to state the three "approaches". Please refer to paragraph "4-1 Zakah Obligations on Entirely Privately Owned Islamic financial institutions" reproduced earlier.

It is obvious that those scholars too had attributed the religion of the "owners" to the company. But, even a privately owned company, if it is incorporated under the Companies Act 1965, has a separate legal entity. So, if you accept the principle of separate legal entity, as the "First approach" does, then, the first question is: Can you attribute the religion of the "owners" to the company? Secondly, in that case, the zakat has to be the zakat of the company, not that of the owners. Then, how does the issue of "Who should pay first" arise? Certainly, the "owners" are not expected to pay (first) the zakat of the company from their own funds. The issue of "Who should pay first?" would only arise if the zakat is the zakat of the "owners". Then, the company may pay "first" and if it does not, the shareholders would have to pay it themselves— their own zakat. I have no problem with the shareholders paying their own zakat on income received from the company.

The "Second approach" is that the zakat is the zakat of the "owners" and the company is paying for it first. I have no further comment on it except to reiterate that the questions that I have posed earlier in in this regard remain to be answered.

The "Third approach" hides under the authority of the State (Parliament) to make law: If Parliament makes law requiring companies to pay zakat,

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<sup>11</sup> I thank Mr Rafe Haneef who raised this point when I showed him my draft.

then the companies are obliged to pay zakat. This is not at all one of the “approaches” regarding who should pay zakat first under the Syariah. In this case the company is required by law to pay. It is no different from corporate tax. Why call it zakat at all? What if the law provides that the company must pay the zakat of the shareholders? Then, the same questions that I have raised, including the issue of constitutionality, would arise.

We now come to “Zakah Obligations on an Islamic Financial Institution Owned Completely or Partially by Non-Muslims” and the Research Team’s Opinion. (Please refer to paragraph 4-3 of the ISRA Research Paper reproduced above.) I think I could summarise the Team’s conclusions are as follows:

1. (The Team agrees with the statement that) Syariah does not impose an obligation to pay zakat on non-Muslims.
2. Zakat should be levied on Islamic financial institutions owned by non-Muslims if they operate in a Muslim country.
3. Reason: (The Team agrees with the view that) The concept of separate legal entity is applicable to Islamic financial Institutions. Therefore, zakat is due from them irrespective of the religion of the shareholders.
3. Additional reason: Even though Muslim jurists agree that the Syariah texts do not impose the obligation to pay zakat on non-Muslims, “they made an exception for ‘ushur (excise tax) taken from non-Muslims merchants living inside or outside an Islamic state when they do business in a Muslim country other than their own country. They also made an exception for the Christian Arab tribe of Banu Taghlib, from whom “zakah” was taken at a doubled rate.” (The sentence that follows is interesting). “These scholars see nothing to prevent collecting zakah from non-Muslims living under a Muslim state by designating it as a tax on non-Muslims, if the governing authorities decide to do so.”

Of course I agree with point number 1.

Regarding point number 2, I am not concerned about the conclusion reached by the Team. I am only concerned about the reasoning.

That takes me straight to point number 3. With respect, I think it is erroneous to conclude that a company is obliged to pay zakat simply because it has a separate legal entity without the conditions that make payment of zakat obligatory being satisfied. It should be remembered that the principle of separate legal entity is introduced by 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".<sup>12</sup> The law does not make a company a Muslim or a non-Muslim.

The Team accepts the principle of separate legal entity as relevant and applicable but uses it as the reason or ground for imposing the obligation to pay zakat. In the case of Islamic Financial Institutions which are wholly-owned by Muslims, they seem to impute the religion of the shareholders to the company. However, when the Islamic Financial Institution is partly-owned by Muslims and partly by non-Muslims, they disregard the religion of the shareholders. Instead they apply the test: whether the company is operating in an Islamic country or not. Why not just apply the same test to both: any Islamic Financial Institution operating in an Islamic country is liable to pay zakat? "What is an Islamic country?" I will not go into that debate.

We have now reached the last point (No. 4). Zakat and tax are two different things and must not be confused. Zakat is one of the five pillars of Islam, obligatory upon human beings who believe in the "*Rukun Iman*" (the six pillars of faith) and, by virtue of embracing the faith become Muslims. Tax is what the Government imposes by law on human beings or companies for whatever reason, including purely to raise money for Government expenditure. There is no religion in tax. One should not be speaking of tax as an exception to zakat. For the same reason, one should also not be speaking of tax as part of zakat. To do so, would be adding something else to the third pillar of Islam. It is like saying that praying at Masjid Al-Aqsa is part of the *ibadah* of *Hajj*. That is not a human prerogative.

The last sentence that I quote above is an anti-climax really. If the Government wants to collect tax from the companies why try to justify it as zakat (except that if it were zakat, it would go to the states' *Baitul Mal* instead of the Federal Treasury)? Even now companies are paying tax. There is no need for fatwa, decision or research paper.

However, let me give a word of caution again. In Malaysia, a law which levies zakat on anyone, human beings or companies, other than "persons professing the religion of Islam" is unconstitutional.

With respect, there are uncertainties in the decision and confusion in the reasons thereof. I think a fresh paper should be prepared not by Syariah scholars alone, but jointly with lawyers who are well-versed in companies' law, auditors, representatives of the relevant authorities and the industry. Among, the issues that should be addressed are:

1. Take note that, in Malaysia, a company incorporated under the Companies Act 1965, by operation of law, has a separate legal entity.

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<sup>12</sup> Julio C Colon, a US Attorney, in his correspondence with me.



2. Take note that zakat is one of the five Pillars of Islam (*Rukun Islam*) which is obligatory on human beings who believe in the six Pillars of Faith (*Rukun Iman*).
3. Take note that the Constitution only permits zakat to be levied on “persons professing the religion of Islam”. Any attempt to levy zakat otherwise than on “persons professing the religion of Islam”, including companies, is unconstitutional.
4. Take note that companies are not under the State List and outside the jurisdiction of the Syariah Courts.
5. Is zakat (like *shahadah*, prayer, fasting and *hajj*) obligatory on other than Muslim human beings?
6. What is the effect of the principle of separate legal entity of a company with regard to the five Pillars of Islam, including zakat?
7. Whether companies have to satisfy the five conditions applicable to human beings before they become obliged to pay zakat? Whether we can attribute the religion of the shareholders to a company for the purpose of making the company liable to pay zakat (even then not including *fitrah*) only?
8. Whether income received by a company before distribution of dividend is the income of the shareholders liable to zakat? Whose zakat?
9. If a company is obliged to pay zakat, is it its own zakat or the zakat of the shareholders and the company only pays on behalf of the shareholders? In both cases from whose funds that the company pays and the consequences that follow.
10. If it is the zakat of the shareholders:
  - a. Whether the company is obliged to pay zakat of the shareholders who have not received the income (or may not receive at all) and who are not (or at least not yet) obliged to pay zakat?
  - b. When the company pays the zakat on the income of the company and then distribute the balance (or part thereof) to the shareholders, the shareholders will have to pay their individual zakat again on the income for which zakat has been paid by the company. The individual shareholder is then subjected to double zakat.
  - c. If a company pays the zakat of the shareholders, why should the company be entitled of a rebate of its own tax? The tax rebate should be given to the shareholders.
  - d. So far we are assuming that the shareholders are human beings, Muslims and non-Muslims. That is not usually the case. In reality there are many layers of corporate shareholders before we arrive at

the human being shareholders, Muslims or non-Muslims. So, even if it is said that we could attribute the religion of the shareholders to the company, how do we attribute it in such cases? The question whether they themselves are obliged to pay zakat is equally relevant.

11. Considering all the factors, especially in Malaysia, perhaps, a better way out is to keep zakat and tax separate. Zakat should only be the obligation of Muslim human beings (as provided by the *Qur'an* and the *Hadiths*) or "persons professing the religion of Islam" (as provided by the Federal Constitution, both expressions actually mean the same thing). Whatever zakat that should be collected, should be collected from the Muslim human beings. Whatever tax that should be collected from companies should be collected from the companies. Zakat and tax are two different things. They should not be confused.
12. One should not be influenced by the results, whether the zakat or tax collected goes to the Federal Treasury or the state's *Baitul Mal*. To take that into consideration is to be biased from the start. Neither *fuqaha* (Islamic jurists) nor judge should allow themselves to be influenced by such factors.

I foresee that, when this kind of arguments are raised, it will be seen as being "unfriendly" (that is the mildest word I can find) to Islam. Blame will be made on common law, the framers of the Constitution and common-law trained lawyers. To be fair, we should remember that at the time the Constitution was being drafted, there was no *fatwa* yet that companies incorporated under the Companies Act 1965 were obliged to pay zakat. The decision that we are discussing came almost four decades after independence, even then, only a few States have half-heartedly come up with a *fatwa*. Furthermore, at the time the Constitution was being drafted, no one, not a single individual or group of Syariah scholars, made any representation to the Reid Commission for provision to be made that companies be included in the term "*persons professing the religion of Islam*" or whatever term the Commission decides to use.

Lastly, I do not say that my views are right. I only say that these are my views at this point of time and I hope that someone would clarify the position.