Revisiting Dividends, Capital Asset Purchase and Donations in Business Zakat Assessment: The Malaysia Experience

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Abstract

Despite the fact that the centres for zakat management and the public have already used the assessment method of business zakat as introduced by the Malaysian Department of Islamic Development (JAKIM), several issues remain unresolved, such as inconsistencies and differences in the assessment value of business zakat. Issues pertaining to dividends paid to subsidiaries that have paid zakat, purchasing fixed assets at the end of the permissible period and donations made at the end of the permissible period are some of the issues that influence the amount of zakat payable. This paper aims to analyse these three items involved in the assessment of business zakat in order to harmonise the existing zakat accounting method. It is found that these three items should be treated consistently in order to develop a consistent, uniform and fair zakat accounting method.

Keywords: Zakat Accounting Method, Business Zakat

1. Introduction

Business zakat is the compulsory zakat payable on business assets. The term business asset originated from the Arabic word "*urud al-tijarah*". Scholars in the beginning of Islam had differing opinions when establishing business zakat, specifically related to the payable amount (*nisab*), period for assessing zakat (*haul*) and the interpretation of the term "*urud al-tijarah*". Scholarly reasoning (*ijtihad*) was more focused and appropriate targeted on business assets that existed during their time.

The history of zakat collection in Malaysia shows that there are differences among centres for zakat collection in Malaysia, especially in interpreting the meaning of business items (*urud al-tijarah*). Among the definitions of "*al-tijarah*" given by Islamic religious scholars is assets obtained from business transactions (Mohamed Abdul Wahab et al., 1995). Thus, the centres for zakat collection in Malaysia, specifically in Perak, Kedah, the Federal Territory and other states assume that business items include current assets such as cash, accounts receivable and inventory valued at cost (Ahmad Othman, 2003). The Haj Board and the Zakat Section of Perak Islamic Religion and Malay Custom Council (MAIP) define business items as items that can be transacted including current assets and returns on investment (ZahriHamat, 2000). Bank Islam Malaysia Berhad has defined business items as net current assets (current assets minus current liabilities) and net profits in a year (Ahmad Othman, 2003). The contemporary scholar, such as al-Zuhaili, has defined business items as "items in this world such as decorations, immovable assets, animals, plants, etc. that are meant for business." He added that Malik, also a religious scholar, was of the opinion that decorations meant for business were also included as business items (Al-Zuhaili, 1999).

In general, the difference between business items subjected to zakat and those not subjected are evaluated based on the intention of using the asset. Therefore, if the owner prepares an asset (either movable or immovable) for transaction, hence the asset is deemed as a business item and will be subjected to zakat payments. On the other hand, if an asset (either movable or immovable) becomes a place of domicile, a store for business items or a place of trade then the asset will be exempted from zakat payments. Al-Zuhaili summarized the views of the four main madhabs of the *AhliSunnahWalJamaah*, which are the religious scholars from the Hanbali, Hanafi, Maliki and Shafi'imadhabs, by specifically stating the conditions that need to be fulfilled. The Hambalimadhab has stipulated two conditions, which are (1) business items have to be owned through the owner's efforts by buying the item and (2) there should exist an intention to trade while owning the asset. The madhab has also set four conditions for the business item, whereby the item should have an adequate price, having reached a qualified period for assessment of zakat, intention to trade and the effort to trade (intentions without efforts are not enough). The Maliki madhab has stipulated five conditions, which are (1) business items should not depend on the zakat alone (for example gold and silver that depend on gold and silver zakat or cattle/buffalo that depend on livestock zakat), (2) trading items obtained through sales and purchase (not inherited or obtained as gifts), (3) the intention to trade exist when purchasing, (4) the price (value) used to purchase trading items is by a buying and selling transaction and not through inheritance or gifts and (5) to differentiate between a contemptuous trader (*muhtakir*) and a non-contemptuous trader (*mudir*). The Shafi'imadhab has stipulated six conditions, which are trading items obtained via a buying-selling transaction only and no other means, an intention to cash in on the asset when it does not meet the amount payable (*nisab*) and the value of the trading items would reach the payable amount (*nisab*) or value at the end of the assessment period (*haul*).

Although there are numerous conditions needed to fulfil the category of a trading item, hence, only three conditions have been agreed upon by all the religious scholars, which are (1) reach the payable amount (*nisab*) or value, (2) fulfilled the period needed for assessment (*haul*) and (3) the intention to trade or carry out a business. Other conditions, if there are any, are extra conditions according to the madhabs. Although the choice to follow any madhab is permitted in Islam, the madhab that is convenient and facilitates calculations, especially for collectors of zakat and business people in the current business situation, is more practical and justifiable to all parties.

2. Problematic Issues in Business Zakat Assessment

The business asset concept in Islam has been scrutinized in detail by religious scholars from numerous madhabs who are experts in Islamic jurisprudence. Hence, few items brought about differences in thought pertaining to the definition of business assets. What makes it more difficult is that business assets today are reported in financial statements of companies according to regulations and conventional accounting standards based on Western philosophies. Thus, only accountants who are educated on the Western accounting system understand this method of accounting. Therefore, those staff of the centres for zakat collection with an Islamic education background would face difficulty in understanding the conventional zakat accounting system except for those who has formal knowledge in the field of accounting (Nik Mustapha Nik Hassan, 1987). Consequently, majority of business people with a Western education would find it difficult to understand the regulations on business asset ownership according to Shariah.

These religious experts on Islamic *fiqh* have generally outlined the assets that need to pay compulsory zakat and those that do not need to pay, reflecting on the current reality of business assets. Since 20 centuries ago, these religious scholars have discussed issues related to *fiqh* and zakat accounting. The present developments have occurred following the abrupt changes in the method of accumulating new wealth. Therefore, the challenge for current religious experts on Islamic *fiqh* is how to deliver their views on scrutinizing the present reality and henceforth to arrive at a religious consensus (*ijtihad*) pertaining to the issues.

The latest research has shown that there are still many important issues that need to be addressed on the question of zakat although there have been reforms specifically related to business zakat in Malaysia (Abu Al-HasanSadeq, 1994). In regards to the question on business zakat accounting, one point that has been specifically identified is the difference in zakat assessment evaluation.

Basically, zakat assessment accounting focuses specifically on tradable goods (*urud al-tijarah*) only. They are assets that can be traded. Since there are differences in valuating tradable goods according to madhabs, the eventual valuation would render differing valuation values.

These differences are treated fairly because their valuations are in accordance to difference madhabs. However, surprisingly, the differences in valuation are occurred within the same madhab and in the same category of assets in the same methods as practiced in Malaysia. Research by Ahmad and Sanep (2010) revealed that although the same method is used in evaluating the zakat of a trader, it could still produce different assessment evaluations. This situation happens in some cases involving deductions and non-deductions related to debts and business inventory. This situation has arisen due to the inconsistencies in the principals involved in calculating deductions. There are also several specific items that need re-examining such as dividends received from subsidiaries, purchasing assets at the end of the period for assessing zakat (*haul*) and donations or contributions at the end of the period for assessing zakat (*haul*). The question is how this can occur, what the effects are and what are the steps taken to overcome them. Therefore, this paper will examine and debate issues related to the assessment of business zakat, specifically related to conditions that enable zakat collection involving dividends received from subsidiaries, purchasing assets at the end of the period for assessing zakat (*haul*) and donations or contributions at the end of the period for assessing zakat (*haul*). This paper will also look into several views that may indicate a consistent and fair assessment.

3. Methods for Assessing Business Zakat, Issues Arising and its Effects on Assessment

3.1 Zakat Accounting Methods

Three main methods are identified to be frequently applied in calculating zakat in Malaysia (Mohamed Abdul Wahab et al., 1995). These methods are:

- Zakat Accounting based on Current Assets

This method is practised by the *Baitul-Mal* in the states of Perak, Kedah, Terengganu and the Federal Territory. Among the elements in the current asset that are considered for assessment of zakat are cash (both in hand and in the bank), accounts receivable and inventory valued at cost.

- Zakat Accounting Based on Currents Assets and Investment Profits

This method is practised by the *Baitul-mal* in the state of Perlis and the Board of Management and Tabung Haji (LTH). This method is almost similar to the earlier method mentioned above but has added features such as investment profits and inventory at current value.

- Zakat Accounting Based on Net Working Capital and Business Profit

Bank Islam Malaysia Berhad practices this method, whereby the amount of zakat payable is calculated by totalling the value of all the current assets minus the total current liability and is added to the bank’s net profit.

Hence, when implementing the actual zakat assessing mechanism, there are several differences in the technical items.

3.2 Zakat Calculation Methods

There are several methods of calculating zakat that are practiced in the centres for zakat management in Malaysia based on the general method (Ahmad Othman, 2003). Zakat accounting based on current assets in divided into two, depending on considerations given to investment and current liability, while zakat accounting based on the working capital involves current liabilities and adjustments. The methods are elaborated as follows:

- Current Assets + Investment

This method assesses zakat based on current assets. Although the basics of the current assets are used, hence, several adjustments to the assets have also been initiated. However, all forms of investments are considered when calculating zakat. These investments include investment in normal shares, preferred shares, bonds, notes payable, rights and warrants, investment in subsidiaries, investment in federal companies, business debts accrued from expenditure of more than one year being brought forward and other forms of investment. Among the adjustments made are deductions on the benefits or illicit interests received, bad/doubtful debts, obsolete/ impaired inventory and welfare funds. The business inventory implicated is the inventory on manufactured goods, inventory on semi-manufactured goods and inventory on raw materials or supplies deducted from the current assets. All kinds of debts, including deposits of basic amenities, monetary advance and staff loans, all kinds of advance payments, debts of directors and debts of subsidiaries are liable to be assessed for zakat. Cash in the bank, either Islamic or conventional banks, is taken into account except bank interest. This method is used by centres for zakat management in the states of Johor, Kedah and Kelantan.

- Current Asset + Investment – Current Liability

This method assesses the zakat based on current assets. It is different from the first method in that this method takes into account current assets and short-term investment and allows the deduction of certain liabilities. The kind of investments taken into consideration includes investments in ordinary and preferred shares, investments in bonds while other long-term investments are also considered. Subsequently, investment in debt notes, rights, warrants, subsidiaries and federal companies were not considered. All types of inventories including inventory on manufactured and semi-manufactured goods and inventory on raw materials or supplies are considered as assets eligible for zakat assessment.

All debts are considered here including business debtors, debt notes, staff debtors, staff loans, all types of credit, debts by directors and subsidiaries and other debtors and deposits towards amenities such as water, electricity and telephone. All types of cash savings including, cash in the bank and hand, are also subjected to zakat payments. Thus, all forms of interest and illicit monies are deducted from current assets. Among the current liabilities that would be deducted are business creditors, operations creditors, and other creditors, dues to related companies and directors and all types of short-term loans including overdrafts, Islamic and conventional modes of short-term and long-term liabilities that will mature in 12 months. Suggested taxes and dividends are not given deductions. This method is used by centres for zakat management in the states of Perak, Melaka, Negeri Sembilan and in the Federal Territory.

- The Working Capital Method (Current Assets-Current Liabilities=Adjustments)

This is a new method introduced by the practitioners and academicians. Furthermore, JAKIM (2001) had suggested the Working Capital method and the Expanding Capital method in the book “Guide to Zakat in Malaysia”. According to this book, the Working Capital Method (also known as the *Syariah* method) and the Expanding Capital Method (also known as the *Uruffiyah* method) are similar and yield zakat assets before similar adjustments in value. This method was initially used by a few states such as Selangor, Pahang, Terengganu and Perlis.

The method’s formula is as below:

Working Capital Method	*Expanding Capital Method*
Current Assets – Current Liability + Adjustment	Capital and Long-term Liability – Fixed Assets and Non-Current Assets + Adjustment

Adjustments cover permitted and non-permitted items. Among the items that are affected by adjustments are dividends received from subsidiaries, assets purchased at the end of the zakat assessment period (*haul*) and donations or contributions at the end of the zakat assessment period (*haul*).

4. Several Accounting issues in Business Zakat Assessment and its Effects on Zakat Assessment Values

Presently, JAKIM has introduced the Working Capital and Expanding Capital methods in efforts to create some uniformity. The question that arises in using these methods is related to the adjustment items, which are the dividends received from subsidiaries, assets purchased at the end of the zakat assessment period (*haul*) and donations or contributions at the end of zakat assessment period (*haul*). The adjustments of these three items need actual re-evaluation and justification in order not to betray the trust of zakat payers. The questions pertaining to dividends received from subsidiaries, assets purchased at the end of the zakat assessment period (*haul*) and donations or contributions at the end of the zakat assessment period (*haul*) and the effects are elaborated as follows:

- Dividends Received from Subsidiaries

In current accounting practices, the accounting period for subsidiaries is similar to the parent company. The business zakat assessment method suggested by JAKIM does not recognize dividends received from subsidiaries and the deductions given when calculating business zakat. The reason being that dividends received from subsidiaries have paid zakat, hence, it is improper to pay zakat twice on the same asset, hence the parent company does not have to pay zakat to the subsidiaries. However, this condition cannot be accepted for the following reasons.

Dividends received by a parent company in the current year are related to dividends declared for the previous financial year. This is because dividends received from subsidiaries are not related to the accounting period of the parent company. Therefore, by rejecting the dividends received from subsidiaries will release a particular quantum of assets from zakat and reduce the assets that are liable for zakat payments of the parent company. Subsequently, this will reduce the zakat paid by the parent company. Thus, the reason of putting aside dividends received by the parent company in order to evade double zakat payments is illogical and cannot be accepted. Hence, if the subsidiaries' non-receivable dividends are recorded in the parent companies non-receivable accounts for the same accounting period, then appropriately the amount of non-received dividends should be deducted when calculating the parent company's zakat.

- Purchasing assets at the end of the zakat assessment period (*haul*)

In the current business practice, assets are purchased according to needs and strategies. The business zakat assessment method suggested by JAKIM does not recognise capital assets purchased during the last quarter of the year and does not allow deductions when calculating business *zakat*. However, the intentions of the businessperson investing in assets at the end of the accounting period should not be questioned, while making huge investments primarily to avoid paying zakat is not a wise decision. The researchers wish to adduce a few reasons that the zakat assessors should consider before the adjustment is permitted. Firstly, if the businessperson makes an investment on assets at the last quarter of the year purposely to avoid zakat, hence the costs incurred would be more than that compared to the 2.5% business zakat rate on the assets in question. For example, legal costs, evaluation costs and most prominently are costs of depreciation, deteriorating value and devaluation. Obviously, it is unwise for a businessperson to invest in assets at the end of the period just for the sake of evading zakat payments. The second reason is that capitals asset purchased during that period are assets that have been cleared from zakat payments (assets that have been assessed for zakat the previous year) or that have not fulfilled the required period (current profits). Hence, both these reasons justify the need for the above condition to be disregarded when calculating business zakat. The actual intention of businesspersons purchasing assets at the end of the business period should not be questioned. This situation would reflect the lack of confidence in the zakat administrators towards the zakat payer's sincerity.

- Donations or contributions at the end of zakat assessment period (*haul*)

The business zakat assessment method suggested by JAKIM does not recognise donations and contributions made in the last quarter of the year and the deductions permitted in calculating business zakat. The reason for reclassifying is to absolve it from zakat payments and considered zakat have higher priority than donations and contributions. This condition presupposes that the zakat assessor questions the intention of the businessperson who donates at the end of the accounting period. The researcher wishes to adduce several relevant reasons that the zakat assessor needs to consider before the adjustment is permitted. Firstly, the donations made during the stipulated period are from the assets that have already been paid the zakat the previous year or have not reached the period of maturity (current profits), hence it is not proper to deny the donation. Denying the donation because it has not paid the zakat is illogical because the asset has been absolved of zakat the previous year or the new asset has been obtained within the current period (before reaching the *haul*). Secondly, this adjustment would further complicate calculation of the zakat and the reasons are too trivial. The researcher has again reiterated the businessperson's intentions in donating assets at the end of the period permissible (*haul*) should not be questioned. This situation would reflect the zakat administrator's lack of confidence on the sincerity of zakat payers.

5. *Suggestions on the Evaluation of Dividends Received, Purchasing Capital Assets and Donations in Business Zakat Accounting*

Dividends received, purchasing capital assets at the end of *haul* and donating at the end of *haul* appears to be issues that have a great impact on collection of business zakat and the morale of the centres for zakat management. From one perspective, the business zakat assessment method by JAKIM would produce higher zakat collections by applying the adjustments as stated above but from another perspective, these adjustments would have a negative impact on the zakat collection method itself and the zakat collection authority. Differences in zakat assessment values can cause suspicions among businesspersons, which subsequently has an effect on the businesspersons and they would eventually be reluctant to pay zakat in the future.

Therefore, zakat assessment on dividends received by the parent company, purchasing capital assets at the end of *haul* and donating at the end of *haul* needs to be reconsidered so that businesspersons are fairly treated when having the business zakat assessed. However, what's more important is that the zakat assessment method needs to use consistent principles when assessing zakat.

The classical religious scholars have also identified the factors that determine the eligibility of assets or wealth that can be assessed for zakat (al-Qardawi, 1996). Among the principles introduced by them pertaining to this matter was growth (*al-Nama'*). The meaning of this principle on expansion or growth refers to the returns to the owner in the form of profits and good fortune or advantages accrued from owning the assets. This expansion characteristic is based on the sources of the al-Qur'an and al-Hadith regarding property that is deemed compulsory to pay zakat (Al-Qardawi, 1996). This principle is frequently used in economics and has become a validated reason in the zakat system. By using this principle, the scope of item envisaged for zakat assessment could be expanded to cover other assets that have expanded naturally or through self-effort (MujainiTarimin, 1996). The religious scholars have laid down a condition whereby an asset may need to pay zakat if the asset has actually expanded or has the potential to expand. Accordingly, an asset that has not expanded or does not have the potential to expand, such as bad debts, impaired or outdated inventory and fixed assets, will not be assessed for zakat.

Therefore, assets whose dividends have been received from the parent company still possess the characteristics to expand and it is appropriate to be considered for business zakat assessment. Based on the above argument, all three items related to the above stated adjustment needs to be reconsidered in order to adduce a business zakat assessment that is uniform and fair to all zakat payers.

6.Conclusion

This paper has emphasized that the business zakat assessment needs to be revised based on the view that the current practice relies on inconsistent principles. Dividends received from subsidiaries, purchasing capital assets at the end of *haul* and donating at the end of *haul* have caused some assets to be exempted from zakat. Meanwhile, there are assets that have been assessed for zakat based on inappropriate reasons. This inconsistency has had an implication on the zakat assessment values and the integrity of the centres for zakat management. A re-evaluation needs to be carried out specifically on these three items that have been discussed earlier on the assessment method and zakat accounting in order to develop a consistent assessment value.

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