

# International Workshop on Reassessing Waqf, Zakat, and Takaful : The Revival of Islamic Welfare Institutions in Asia

Date

January 23rd and 30th (Saturday), 2021

Venue

Zoom Online Workshop, Ibaraki Campus,  
Ritsumeikan University, Osaka, Japan

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## Fiqh of Waqf and Zakah: Classical and Contemporary Developments

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# Presentation Outline



- Issues in Forms of Wealth and Produce Subject to Zakat
- Potential Inconsistency in Zakat Estimation and Collection
- Reassessing Zakat Administration in Modern Economies
- Institutionalizing Zakat & Waqf in Integrated Microfinance

# Utilizing Distinct Features of Zakat, Waqf and Sadaqah for Institutionalization

| Zakah  | Waqf  | Ordinary Sadaqah  |
|--|---|---|
| <ul style="list-style-type: none"> <li>• Compulsory</li> <li>• Heads of Zakah are specified in Holy Qur'an.</li> <li>• Specific financial or commodity flows.</li> </ul>   | <ul style="list-style-type: none"> <li>• Voluntary</li> <li>• Beneficiaries can be anyone.</li> <li>• The flow of benefits on a sustained basis. ‘ibdāl’ (exchange) and ‘istibdāl’ (substitution) of Waqf assets provide flexibility and sustainability.</li> </ul> | <ul style="list-style-type: none"> <li>• Voluntary</li> <li>• Beneficiaries can be anyone.</li> <li>• Specific financial or commodity flows.</li> </ul> |
| <ul style="list-style-type: none"> <li>• Transfer of ownership to a living Muslim is necessary. Hence, allocation and disbursement are usually contemporaneous.</li> </ul> | <ul style="list-style-type: none"> <li>• Naturally open to institutionalization due to the donation being of an asset that remains intact or has potential to grow.</li> </ul>  | <ul style="list-style-type: none"> <li>• May or may not be open to institutionalization depending on the nature and value of sadaqah.</li> </ul>        |

# Issues in Forms of Wealth and Produce Subject to Zakat

## Multiple Nisab on Different Forms of Wealth

- A diversified wealth base may result in Zakat exemption despite sizable aggregate value of wealth. Even in liquid wealth, Nisab in silver and gold at current market value differ significantly resulting in completely different exemption amount.

## Some Wealth Zakatable May Result in Avoidance & Inconsistent Impact

- There is wealth Zakat at 2.5% rate on gold and silver even if not held for trade. But, on other minerals like diamonds, there is no Zakat if not held for trade. If just before the Zakat due date, a person converts cash or gold into diamonds, then the Zakat due amount will go down.

# Issues in Forms of Wealth and Produce Subject to Zakat



## High Value Added Production Exempted from Production Levy

- Production from agriculture which results in much less value addition and contribution margins (i.e. difference between selling price and variable cost) is subject to production Zakat at 5% or 10% value of the produce.
- Agriculture sector is the mainstay of employment of poor masses in developing countries and it is their prime source of exports.
- However, industrial production is not subject to production Zakat. It is subject to wealth Zakat of 2.5% only if the industrial output is held for trade on a certain date in a year.

# Issues in Forms of Wealth and Produce Subject to Zakat

## Inconsistency in Incidence Based on Different Nature of Businesses

- A producer and trader of big ticket items like expensive consumer durables and specialized capital goods for firms would have lower inventory turnover ratios and relatively higher monetary values of inventory than trader and producer of fast moving consumer goods.
- Nonetheless, the former class of traders and producers are required to pay Zakat on the whole value of inventory regardless of whether ex-post net income is positive or negative. This might put them in a disadvantageous position.

# Potential Inconsistency in Zakat Estimation and Collection

## Business Cycle Downturn May Put More Pressure on Trader

- If inventory is taxed rather than income, then the trader and producer struggling to make sales is burdened even more through wealth Zakat irrespective of whether a trader and producer is able to make enough sales, let alone earn any profits. It may instigate a deflationary pressure in the economy when unsold inventory is sold at significantly deflated prices causing recession and unemployment.

## Different Treatment of Liquid Capital and Physical Capital

- If working capital management is carried out in a way that cash flow received near the Zakat due date is used to purchase fixed assets in businesses, then Zakat collection would go down since means of production in a producing concern are exempted from Zakat.

# Potential Inconsistency in Zakat Estimation and Collection

## Proposals on Zakat on Shares Yield Different Outcomes

- Investment in shares is subject to wealth Zakat at 2.5%.
- If investment is made with the intention to obtain capital gain, then the entire value of shares constitutes Zakat base.
- Else, if investment is made with a long term holding view to obtain dividends, then only assets subject to Zakat constitute Zakat base, i.e. cash in hand, bank deposits, receivables, investments and tradable inventory.
- Hanafi jurists allow all debts to be excluded.
- Maulana Taqi Usmani suggests deducting debts that are taken to obtain Zakatable assets only.
- Shafie jurists do not allow debt to be excluded. If all debts are to be excluded, then there remains little (if any) positive Zakat base which only constitutes handful of current assets.
- Some Muslim economists like Monzer Kahf favour Zakat on physical capital stock and do not consider them exempted as means of production.

# Potential Inconsistency in Zakat Estimation and Collection

## Zero Interest Loans and Receivables Become Costly for Zakat Payer

- If investment value is made subject to Zakat, long-term investment automatically has a -2.5% hurdle rate to climb. Providing *Qard-e-Hasan* on medium to long term basis will result in lender incurring inflation cost, i.e. decreasing purchasing power, plus the obligation to pay *Zakat*.

## Need for Filters on Consumption to Ensure Redistribution

- Durable goods consumption beyond necessities can reduce the Zakat eligible wealth. However, it is quite subjective as for the same nature of durable goods like cell phone, laptop and automobile; there are various products with wide price range.

## Condition of Strict Tamlik Limits Usage Beyond Asset Transfer

- The condition of ownership transfer to the individual human being in Zakat limits usage for Zakat funds in providing indirect benefits through building schools, hospitals and producing public goods that benefit society at large.

# Reassessing Zakat Administration in Modern Economies



- Nusus (Qur'an o Sunnat) shall be the primary source to think over redesigning system of administration. For instance, Nisab and rates which are mentioned in Nusus can not be altered.
- Nonetheless, forms of wealth and value creating activities change with time. Ijtihad Bil Qiyas from Nusus is possible and is used in Islamic jurisprudence in recent past.
- For instance, Umar (rta) brought horses in Zakat net. Usman (rta) brought production in forests in Zakat net. Thus, a policy maker in a modern economy can use this institution flexibly to maximize the welfare benefits of the Zakat system.

# Reassessing Zakat Administration in Modern Economies



- Such deliberations can be revisited and modified in the light of experience, new knowledge, and new ways of administration. For instance, block chain technology allows efficient storing and retrieval of data.
- For the hardships and difficulties due to which Amwal-e-Zahira were focused upon for Zakat collection by external agency, technology may solve some of the administrative hurdles.

# Reassessing Zakat Administration in Modern Economies

- **From the economics standpoint, there is a need to revisit contemporary forms of wealth, business organizations, modes of finance and operations of institutions to come up with consistent rulings on new forms of wealth, production and income-earning pursuits.**
- If Zakat is meant to purify wealth as stated in Nusus (*Al-Qur'an*, 9: 103), considering only some wealth as subject to Zakat opens loopholes and room for Zakat arbitrage.

# Reassessing Zakat Administration in Modern Economies

- **From economics perspective, any asset, real or financial, that can perform the function of store of value can be classified as one of the forms of wealth.** This view is put forward by Yousuf Qardawi (1984) and supported by Abu Bakar et al. (2007) and Haneef & Mahmud (2011).
  - General texts of Qur'an and Sunnah confirm that there is a right, a Sadaqah, or a Zakah, on all wealth (Qardawi, Fiqh uz Zakat, 1984, p. 63)
  - Wealth of any kind is in need of purification (Qardawi, Fiqh uz Zakat, 1984, p. 63).

# Reassessing Zakat Administration in Modern Economies



- Likewise, value creating activities are not limited to agriculture.
- In composition of GDP in most countries, manufacturing and services sector together constitute close to 80% of GDP.
- In manufacturing, the value creating activities resulting in tangible goods production are subject to Zakat at 2.5% rate on a single day in a year.
- In services sector, such value creating activities do not usually result in storable inventories.

# Reassessing Zakat Administration in Modern Economies



- If the essence of Zakat on production is to charge value creating production out of commercial enterprise, then it can be extended to contemporary value creating activities in manufacturing and services industry.
- Finally, if the means of production in value creating economic enterprise are exempted from Zakat, then **divisible investments through financial securities in value creating economic enterprise can be exempted from Zakat and only the income can be subject to Zakat.**
- Since such income is a flow from value creating activity employing capital and not labour, it shall be subject to Ushr rules rather than Zakat on wealth, i.e. stock. This view is favoured by Prof. Akram Khan (2005).

# Reassessing Zakat Administration in Modern Economies



| Form of Wealth or Value Creating Produce  | Rate of Levy | Method of Collection                        |
|---|--------------|---|
| <b>Zakat on Wealth (non-invested real, trading and monetary assets that store value except those in personal use)</b> | 2.5%         | Charged annually on wealth statement filing |
| <b>Agricultural production with intensive use of both L and K</b>   | 5%           | Charged as VAT                              |
| <b>Agricultural production with intensive use of L or K</b>   | 10%          | Charged as VAT                              |
| <b>Industrial production with intensive use of both L and K</b>   | 5%           | Charged as VAT                              |
| <b>Investment income as markup, dividend, profit share and capital gain with investment of K in financial assets</b>  | 10%          | Deducted at Source                          |
| <b>Rental income with investment of K in real estate</b>  | 10%          | Deducted at Source                          |
| <b>Consultancy income with investment of L in consultancy</b>   | 10%          | Deducted at Source                          |
| <b>Salaried income with investment of L in enterprise</b>   | 10%          | Deducted at Source                          |
| <b>Royalty income with investment in neither L nor K</b>  | 20%          | Deducted at Source                          |

# Reassessing Zakat Administration in Modern Economies



- There will be downward pressure on the prices of durable goods with wealth tax on tradable inventory while allowing exemption on assets in use.
- For instance, if a furniture, consumer appliance or residential facility is unsold at year-end, the seller will have to pay Zakat on it. But, if the asset is sold to the buyer before the due date of Zakat, then the subsequent owner while using such assets personally will not have to pay Zakat on these assets.
- This will help in checking inflation, clearing markets and promoting efficient production processes to reduce inventory cost including physical and fiscal levy on unsold inventory at year-end.

# Reassessing Zakat Administration in Modern Economies



- However, to avoid Zakat arbitrage, the government has to randomly assign Zakat due date for different retailers. It can also enact a policy to levy wealth Zakat on tradable inventory as an average of ending and beginning inventory to counter Zakat arbitrage.
- While there is Zakat on assets in personal use, the government in consultation with Islamic scholars has to legislate what comprises regular and ordinary cost of living per person for different income groups.
- While the government shall not intervene in restraining consumption; at the same time, it shall also not allow people to avoid Zakat by maintaining an extra ordinary living standard.

# Reassessing Zakat Administration in Modern Economies



- Next issue comes in the use of Zakat funds. Can Zakat be paid to the living individuals who belong to the eight Masarif by ownership transfer or can it also be paid to the welfare institutions working on the well-being of one of the eight Masarif, such as hospitals, schools, skills development centers and orphanages.
- If the former is true, then in most cases, only the variable costs of providing operations can be funded through Zakat and broad based expenses of setting up such institutions can be funded through Sadaqat and Cash Waqf. Variables costs that can be funded include:
  - Cost of medicines and treatment for the patients,
  - Fees and accommodation expenses for the students,
  - Boarding and lodging expenses for the travelling patients and students and
  - Living expenses for children in orphanages, for instance.

# Reassessing Zakat Administration in Modern Economies



- However, such institutions also require cost of infrastructure. Some scholars, such as Maulana Amin Ahsan Islahi and Yousuf Al-Qardawi, have argued that Zakat can be paid to institutions which are working for the welfare of poor people.
- Such allocation and disbursement through institutions is more effective and efficient in pooling impactful resources, monitoring and reaching right targets with follow up and continuous support to improve the chances of socio-economic mobility.

# Contemporary Issues in Waqf



- Is Cash Waqf allowed since cash benefits when used up and literal definition of permanent preservation may seem to be absent?
- Is temporary Waqf allowed since it will not involve permanent dedication and transfer of ownership?
- Can the assets be exchanged and substituted if such transformation and revitalization increase the value and benefits of Waqf assets?
- Can the purpose or beneficial use be changed with time through a process with/without consent of Waqif?
- Can Waqf be integrated with commercial finance instrument like Waqf linked Sukuk?

# Blending Zakat and Waqf in Integrated Islamic Microfinance



- The key is to achieve 3 goals: **Scale, Sustainability and Outreach** in innovative ways.
- Need to blend **financial support (asset transfer)** with **non-financial support** in the form of **training and skills development**.
- Effectiveness and impact can be improved by targeting **skills enhancement, financial literacy, computing literacy** and increasing the **business acumen** of clients.

# Structure of the Program

| Supply Side                            |  | Demand Side  |
|--|--|--|
| Financial Funding & Contributions      |  |  |
| External                               | Social contributions via E-Crowdfunding to place Zakat, Sadqah and Waqf funds to IMFI. | Such contributions are used to provide Sadqah and Qard-e-Hasan to the needy clients.   |
|  | Social impact investing via E-Crowdfunding platform.                                   | Proceeds are pooled and then used to provide sale and lease based Islamic financing.   |
| Internal                               | Micro-savings using E-Wallet. Profit sharing ratio higher for micro-savers.            | Clients open remunerative accounts and access money via E-wallet.  |
| Non-Financial Contributions & Services |  |  |
| Individuals                            | Micro-volunteering in training programs by students and professionals.                 | Volunteers provide training, vocational skills and business facilitation in the form of record keeping and basic calculations. |
| Institutions                           | Subsidized services from accredited schools, hospitals and retail stores.              | Clients enjoy access to subsidized services only by spending through E-Wallet so as to incentivize its use.                    |
|  | Micro-Takaful for health risks and accidents.  | Clients with minimum E-Wallet balance get Micro-takaful. Higher savings ensure Micro-Takaful and higher profit share.          |
|  | E-Wallets / Debit Card issued by banks.  | E-Wallets issued by banks are accessible through smartphones and smart cards.  |

Thank You  
Questions & Feedback

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