Shari’ah Standard No. (35)

Zakah

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IN THE NAME OF ALLAH, THE ALL-MERCIFUL, THE MOST MERCIFUL

All praise be to Allah, the Lord of all the worlds, and blessings and peace be upon our master, Muhammad, and his household and all his companions

Preface

This standard aims to identify the Zakah base for Islamic financial Institutions (Institution/Institutions),[1] and indicate the different types of zakatable assets and the liabilities (debts of the Institution) and allocations that have to be deducted from them. The standard also aims to illustrate the payable Zakah rates, and indicate the specific heads of Zakah disbursements.

(1) The word (Institution/Institutions) is used here to refer, in short, to Islamic financial institutions including Islamic Banks.

Statement of the Standard

1. Scope of the Standard

This standard covers identification of the Zakah base for Institutions (including Islamic insurance companies) as well as the subsidiary and the mother company of the Institution (the company). This will be done through identification of the items of financial statements that should or should not be included in calculation of the Zakah base, and the liabilities or allocations that should or should not be deducted from Zakatable assets. The standard also covers payable Zakah rates, disbursement of Zakah funds on the eight categories of Zakah recipients, and the rulings pertaining to disbursement.

2. Procedural Rulings

2/1 Methods of calculation of Zakah base

There are two methods for calculation of Zakah base: the first is the method of net assets, and the second is the method of net investment assets. The two methods have different bases of assessment, yet if such difference is well recognized the final outcome will be the same. This standard is based on the net assets method.

Net Assets Method

2/1/1 Calculation of Zakah base by using the net assets method is done as follows:

Zakah base = Zakatable assets – (liabilities payable during the financial year as at the date of the balance sheet + all installments of liabilities of the financial year which will become due during the coming financial period + rights of the holders of non-restricted investment accounts + minority rights +sovereign rights +waqf rights + charitable rights + rights of non-profit-earning organizations that have no specific owner).

Zakatable assets include: cash and the like, receivables (minus) doubtful debts, assets prepared for trading (such as goods, financial papers and real estate), and financing assets (Mudarabah, Musharakah, Salam, Istisna'a…..). Deductions from financial assets include fixed assets relating to them as well as deductible allocations as shown in item 7.

2/1/2 Assets prepared for trade are to be assessed in terms of their expected cash value (selling market value) at the time when Zakah is due.

2/1/3 In determination of zakatable assets in agriculture and livestock other than articles of trade, application of the ratios and rates specified by Shari'ah should be observed.

2/2 Direct payment of Zakah by the institution

2/2/1 The institution or the company is committed to pay Zakah under the following cases:

a) Enactment of an enforceable Zakah law.

b) Stipulation of commitment to pay Zakah in the articles of association.

c) Issuance of a Zakah commitment resolution by the general assembly.

2/2/2 When the Institution accepts agency for payment of Zakah on behalf of all or some of its equity holders or the holders of investment accounts, funds should be available - or submitted by the principals of such agency - for payment of Zakah on their behalf.

2/2/3 There should be coordination between the mother Company and its subsidiaries with regard to payment of Zakah so as to avoid double payment.

2/2/4 In case of establishing a Zakah fund, or preparing Zakah accounts, clearance by the Shari'ah Board of the institution or the company should be obtained. Clearance by the Shari'ah

Board is particularly required for disbursement of the Zakah funds, when performed directly by the institution/company, or through an accredited Zakah agency. Moreover, a comprehensive report on Zakah disbursements should be presented to the Shari'ah Board on annual basis.

2/2/5 In the absence of any of the conditions indicated in item (2/2/1) above, payment of Zakah shall become the responsibility of shareholders and holders of the investment accounts. In this case the Institution or the company has to indicate the amount of Zakah payable per share or per a given balance of an investment account.

2/3 Zakah-related financial statements

2/3/1 The Balance sheet

Due to the fact that Zakah relates to ownership of zakatable assets, what matters to the Institutions in Zakah calculation is the financial data included in the balance sheet of the institution (the budget), which comprises assets, liabilities, and their related allocations.

2/3/2 Income statement

Income statement (profit and loss account) does not form a basis for Zakah calculation, yet it is referred to for knowing the income or profit of the income-earning fixed assets. In order to pay Zakah the Institution should not necessarily be making profits. Incurring losses by the Institution does not prevent Zakah from becoming due. The Institution is still committed to pay Zakah, except when its liabilities (debtors) absorb all its assets.

3. General Rulings

3/1 Shari'ah definition of Zakah, status (Hukm) of Zakah in Shari'ah, and Zakatable funds

3/1/1 Zakah is a right which becomes due in certain types of wealth, and disbursable to specific categories of recipients. It is an in rem duty when its conditions are satisfied.

3/1/2 Zakah is obligatory on gold, silver, currencies, trade articles, livestock (camels, cows and goats), agricultural produce, minerals and *Rikaz* (treasures).

3/1/3 Zakah is not obligatory on wages, salaries and income from free occupations at the time of receiving such income; whereas it is obligatory on that portion of such income which remains unexpended for a whole year.

3/1/4 Zakah is not obligatory on fixed assets which generate income and which are not acquired for trade, such as leased assets. Nevertheless, at the end of the year, Zakah is obligatory on the remaining portion of the income generated by these assets.

3/1/5 Zakah is not obligatory on public wealth (public sector) or the insurance funds of public institutions.

3/1/6 Zakah is not obligatory on the charitable Waqf (*al-Waqf al-Khayri*). As regards the family Waqf (*al-Waqf al-Ahli*) the beneficiaries should pay Zakah, at the end of the year, from that portion of the Waqf income which remains unexpended.

3/1/7 The above ruling which relates to exemption of charitable Waqf from Zakah is also applicable to trust funds as well *Irsad* (allocation) of public funds and properties for (non-profiteering) educational, charitable, and social Institutions, which have no specific owner, even if such institutions make profits.

3/2 Conditions for Zakah obligation

3/2/1 Full ownership

Full ownership materializes when nobody else has a right in the asset in question, the owner can dispose of the asset the way he likes, and the owner of the asset is the sole owner of the income generated from the asset. In this case, no matter if the asset is allocated for any specific purpose other than settlement of debts (for instance, no matter if it is allocated for implementation of investment projects).

3/2/2 *Nisab* (Zakatable wealth stratum)

The *Nisab* for gold regardless of its form is 85 grams of pure gold or its equivalent in currency (paper or coins), and the same *Nisab* is also applicable to articles of trade after valuation, as well as to extracted minerals. For silver, the *Nisab* is 595 grams of pure silver. The *Nisab* which is widely recognized as applicable to articles of trade is that of gold. *Nisab* for Zakah on livestock is shown at the end of this standard.

3/2/4 Al-Hawl (Zakah year)

The Zakah year for cash and commercial assets as well as livestock is a lunar year (354 days). In case of adopting the solar year for cash and commercial assets, the Zakah rate becomes 2.577%.(2) As regards agricultural products no consideration is to be given to the Hawl (Zakah year) because what matters is harvesting. Similarly what should be considered for minerals and Rikaz (treasures) is their extraction.

3/3 Applicable Zakah rate

The rate of Zakah applicable to gold, silver, currencies and articles of trade is 2.5% - with due consideration to item 3/2/3 above - , whereas the rate applicable to agricultural produce is one tenth (10%) for the produce of non-irrigated lands, half of the tenth (5%) for the produce of irrigated lands, and three quarters of the tenth (7.5%) for the produce of partially irrigated lands. Zakah rates applicable to livestock are shown at the end of this standard.

4. Fixed Assets

4/1 Operational fixed assets

Zakah is not obligatory on operational fixed assets such as the premises of the institution and its equipments; or on intangible assets such

(2) In a leap year the rate is 2.5775

as patent rights, trademarks and computer software. Zakah is also not obligatory on moveable assets acquired for operation (other than those prepared for trade) such as spare parts and tools used for further production, even when such assets are kept in the warehouses.

4/2 Income-generating fixed assets

There is no Zakah on fixed assets which generate income like *Mustghallat* (leased assets), if such assets are not acquired for trade. Nevertheless, Zakah is obligatory, at the end of the year, on the unexpended portion of the income generated by such assets, by adding that portion of income to the other zakatable assets and applying the Zakah rate.

Income-earning fixed assets appear in the financial statements under the following items:

4/2/1 Mustaghallat (leased assets such as real estate properties, transportation vehicles..etc.). At the end of the year, the unexpended rental of these assets is to be subjected to Zakah by adding it to other zakatable assets.

4/2/2 Real estate investments: At the end of the year, the unexpended income of these assets is to be subjected to Zakah by adding it to other zakatable assets.

4/2/3 Capital projects under implementation (which are not for trading)

If a project of this type happens to generate income at some of its stages of implementation, Zakah is obligatory on the unexpended part of that income, after adding it to zakatable assets at the end of the year. If such projects are being implemented for trading purposes. [see item (5/2/6/3)]

4/2/4 Investments in shares with the aim of retaining them (*Nama`*)

If it is possible to know through the company what is the exact amount of Zakatable assets (cash, articles of trade and repayable debts) per share, Zakah can be levied on that amount, otherwise Zakah is to be levied on the portion of zakatable assets per share, which has to be reached through estimation. If the company has no zakatable assets, Zakah is obligatory on the remaining part of the net income at the end of the year.

As far as shares owned for non-trading purposes are concerned, no allocation for deterioration in the value of share investments should be made from the zakatable assets. Regarding shares acquired for trading purposes, the ruling on articles of trade (item 5/2) should be applied.

4/2/5 Investment in the shares of subsidiaries

In, accounting, a subsidiary is the entity in which the mother company owns 50% of the shares. The process of Zakah payment in this case starts with calculating the Zakah of the subsidiary independently, and then the mother company pays its share of Zakah in proportion to its shareholding in the subsidiary. The remaining part of the Zakah of the subsidiary is to be paid by the other parties (minority rights). Such arrangement holds true when the subsidiary does not pay its Zakah directly.(3)

5. Zakatable Assets

5/1 Liquid or easy-to-liquidate current assets

Such assets which include cash assets and assets which can be converted into cash (quasi cash), are shown in the financial statements under the following items:

5/1/1 Cash in hand: Zakah has to be paid from these funds. If such funds are in foreign currency Zakah should be paid from the equivalent amount in local currency as per the prevailing exchange rate on the date when Zakah is due.

5/1/2 Gold and silver assets in any form: Zakah on such assets is to be assessed on the basis of their net weight or cash value.

(3) From a Shari'ah point of view, the same ruling is applicable when the mother institution owns less than 50% of the shares of the subsidiary.

5/1/3 Bank balances: bank balances constitute the following items in the financial statements:

5/1/3/1 Current accounts

Institutions and companies should pay Zakah from their current accounts with other Institutions, because such accounts constitute debts that will certainly be settled. Current accounts include those with the central bank as well as those with other banks. When the Institution obtains interest in such accounts (though it is prohibited) it should pay Zakah from the principal amounts and donate the whole amount of the interest for charitable purposes. For the banks or the Institutions which receive such deposits current accounts constitute liabilities. [see item 6/3/1]

5/1/3/2 Investment accounts

a) The owners of these accounts should pay Zakah from the investment balances as well as the profits, whether such accounts represent short or long term deposits, and even if drawing from the account is restricted by the investment Institution or the owner. If these accounts are invested through permissible modes, what really matters is their share in the investment assets, rather than their share in the invested amounts. Consequently due consideration has to be given to the nature of the assets representing the invested amounts.

   As for the institutions in which the accounts are invested, an account of this type represents a trust (Amanah) rather than a liability, and therefore these Institutions should pay Zakah only on their share of the profits or their commissions, as part of their cash assets.

b) When the investment accounts earn interests (though prohibited) Zakah is payable from the principal, while the entire amount of interest should be donated for charitable purposes. As for the banks in which these interest bearing accounts are deposited, the principal amounts (excluding interest) represent liabilities. [see item 6/3/2]

5/1/4 Bonds, Sukuk and funds

5/1/4/1 Bonds and treasury bills (which represent debts and involve interest – though prohibited): Zakah from the principal of the bond (cost of the bond) should be paid, whereas the entire amount of interest should be donated for charitable purposes. As regards the issuing banks, the nominal value of these bonds and bills represent a liability. [see item 6/3/2]

5/1/4/2 Investment Sukuk of different types: Their owners should pay Zakah on the basis of the underlying assets of these Sukuk, and as indicated in this Standard. As for the Institutions which manage the assets or keep the investment Sukuk, the Sukuk represent a trust (Amanah) rather than a liability, and therefore these Institutions should pay Zakah only on their share of the profits or their commissions, as part of their cash assets.

5/1/4/3 Investment Funds in their different forms: Zakah has to be paid on the basis of the underlying assets of the fund, and as indicated in this Standard.

5/1/5 Amounts retained for documentation of the deal

5/1/5/1 *Hamish Jiddiyyah* (security deposit): This refers to the advance amount which the client pays in order to confirm his binding pledge. Such amount is supposed to cover any harm caused by recoiling of the client from completion of the deal: Zakah on such amount shall be paid by the client. If the amount is deposited in a current account it shall become subject to the rulings shown in item 5/7/3/1 and if it is deposited in an investment account it shall become subject to the rulings indicated in item. [5/1/3/2]

5/1/5/2 The initial security for entering bids as well as implementation security: are to be ducted from the zakatable assets of the Institution which receives them, while the owner of such amount has to pay Zakah it annually as part of his assets, unless he has not been enabled to invest it before refund. When several years elapse before refund, Zakah for one year has to be paid. If such amounts are deposited in an investment account it shall become subject to the rulings stipulated in item. [5/1/3/2]

5/1/5/3 Cash security charged to individuals and Institutions for obtaining certain services such as telephone and electricity services, or security paid on renting shops and equipments: Zakah should be paid by the owner of such amount on refund, and for one year, unless he has been enabled to invest the amount before refund. If the owner of the amount has been enabled to invest it before refund Zakah has to be paid subject to the rulings stated in item. [5/1/5/2]

5/1/5/4 'Arboun (Earnest Money): To be deducted from the zakatable assets of the buyer, while the seller should pay Zakah from it as part of his Zakatable assets, since he will get the amount if the contract is concluded or not.

5/2 Commodity current assets (Articles of Trade)

5/2/1 Articles of trade include anything offered for sale such as real estate and moveable assets, whether the good is being sold in its current state or after manufacturing, and when it is acquired through buying or otherwise. To be subject to Zakah payment such goods should not necessarily be obtained through buying, the mere intention to offer them for sale is quite sufficient.

5/2/2 Articles of trade should be valued at selling market price in the place where they exist, and according to the method of their sale (retail, or wholesale, or if both whichever the predominant). Articles of trade should not be valued at cost or market price whichever the less. However, when other methods of valuation are extremely difficult, valuation at cost can be used for Zakah purposes. When there is a price change during the period between the date of accrual and date of payment of Zakah, the price at the date of Zakah accrual should be adopted.

5/2/3 When the articles of trade are subject to another type of Zakah treatment (e.g., when the articles of trade are livestock or agricultural produce) they should become subject to Zakah on articles of trade only.

5/2/4 In principle, Zakah on articles of trade is to be paid in cash, yet in case of trade recession it can be paid in kind (from the same articles of trade), provided that the interest of Zakah recipients could, thus, be achieved.

5/2/5 Zakah has to be paid on the goods earmarked for the buyer after concluding the contract, even if he has not yet possessed them.

5/2/6 Applications relating to commodity current assets in the items of financial statements

5/2/6/1 Commodity stocks prepared for Trade, raw materials in their different forms, and goods for sale in their original form or after being manufactured by adding them to other materials: To be valued for Zakah purposes at selling market price.

If a good of this type is defective it shall be valued at its selling market price and as per the method of its sale (retail, or wholesale, or if both whichever the predominant). If the good in question is a slow-moving item it can be valued for Zakah at its market price and in its current form. When an allocation is made for such goods it should not be deducted from zakatable assets.

5/2/6/2 Goods in process: To be valued for Zakah at their current market price on the day of Zakah accrual, and if it is not possible to know their market value, they could be valued at cost.

5/2/6/3 Works under implementation (constructions): To be valued for Zakah in their current state on the day of Zakah accrual.

5/2/6/4 Industrial accessories (spare parts) used in production equipment: are not part of Zakatable assets.

5/2/6/5 Goods in transit: To be valued for Zakah at market price in the place where they are found.

5/2/6/6 Goods to be sold by others on commission (by agency): To be valued for Zakah at market price in the place where they are found.

5/2/6/7 Goods imported through documentary credits covered by the Institution, including the expenses of opening the credit and the amounts retained by intermediary banks: Zakah should be paid on the amounts retained for the credit, and not the expenses. When the goods are owned Zakah has to be paid from them on the basis of their market value.

5/2/6/8 Goods prepared for export through documentary credits to the benefit of the Institution: The amounts retained for the credit, are neither subject to Zakah nor are they deductable from zakatable assets, since they have not yet been possessed. However, Zakah has to be paid on the goods that are still held by the Institution as part of its finished goods or goods in process.

5/2/7 Intangible rights prepared for trade such as copy right, patent right, trademarks, and computer software: should be subject to Zakah on articles of trade.

5/2/8 End of the year stock of raw materials (primary materials) which are normally used as ingredients and remain as components of the goods manufactured for trade: Should be valued for Zakah at their market value before entering the process of manufacturing. No Zakah is payable on supporting materials which do not represent ingredients of or remain as components of the manufactured goods, such as fuel and cleaning materials.

5/2/9 Finished goods and goods in process being manufactured for trade: are subject to the same rate applicable to Zakah on articles of trade. Finished goods and goods in process should be valued in their current state and at market price.

5/2/10 Rapping and packing materials: are not to be included in valuation of goods for Zakah if such materials are not prepared for trade separately. Nevertheless, if such materials increase the value of the goods they should be included.

5/3 Receivables of the institution or the company

5/3/1 If the debt owed to the Institution is a cash amount the Institution should pay Zakah on it annually - whether such debt is due or not - since the Institution will certainly receive it. As for bad debts (non-repayable debts) and doubtful debts the Institution does not have to pay Zakah except for one year after collection of such debts, and as per the rulings indicated in item 6/2.

5/3/2 The institution can postpone Zakah on its outstanding debts until full or partial collection. On collection, the Institution has to pay Zakah for the whole past period. When a specific debt is partially doubtful, and an allocation is made for doubtful debts, the doubtful part of the debt can be deducted from Zakatable assets, if the total amount of such debt has initially been included in the these assets.

5/3/3 When the debt owed to the institution by another party comprises interest that has arisen from the process of lending and borrowing or from rescheduling of the debt; the Institution should pay Zakah on the principal only and donate the whole amount of interest for charitable purposes. It should, however, be noted that interest bearing deposits and loans as well as discounting of receipt papers are strictly prohibited dealings which should be avoided.

5/3/4 Applications relating to Receivables in the items of financial statements

5/3/4/1 Debtors: Zakah shall be paid on the amounts payable to the Institution against goods or services sold on debt. In this respect, due consideration should be given to the above-mentioned items.

5/3/4/2 Loans, overdraft accounts, and debt bonds including discounted bonds (zero coupon) and accepted bills (discounted bills): Zakah is payable on the value paid for purchasing the bond, whereas interest – though prohibited – should become subject to the rulings indicated in item 5/3/4.

5/3/4/3 Receipt papers (bills and promissory notes): Zakah shall be paid on the principal of the debt (amount of the paper), including the increment added to the price, if the paper relates to a commodity sold on debt. It shall be noted here that the case will remain the same whether the debt represented by the paper is due or not, since no difficulty is going to be encountered in its collection. If the paper comprises interest the rulings indicted in item 5/3/4 regarding interest should be observed.

5/3/4/4 Amounts retained from contracts: Such guarantee amounts are held by the clients to ensure that the Institution is going to honor its commitments. If the Institution has not been enabled to invest these retention amounts it should not pay Zakah on them. However, on receipt of the amounts the Institution has to pay Zakah on them for only one year.

5/3/4/5 Advance payments on signing contracts: No Zakah shall be paid on them, since they are no longer owned by the Institution.

5/3/4/6 Prepaid expenses: No Zakah is payable on such amounts which represent expenses of forthcoming financial periods, since they are no longer owned by the Institution.

5/3/4/7 Accrued income: It represents income of the current period which has not yet been received, and it shall be subject to Zakah on debts as indicated in item 5/3/1.

5/3/4/8 Legal deposit: It refers to the amount retained by a bank on request of the concerned authorities for the sake of awarding license to the Institution. The Institution cannot withdraw or dispose of such amount except on permission of the concerned authorities. If the institution has not been enabled to invest the retained amount it shall pay Zakah on it for only one year at the time of refund. If such deposit involves interest (though prohibited) the rulings indicated in item 5/3/4 should be applied.

5/3/4/9 Murabahah debtors: It indicates the amounts owed by purchasers. Zakah in this case is payable on total price including profits, as indicated in item 5/3/1.

5/3/4/10 Debtors of Salam goods purchased by the Institution and not yet received: the Institution should pay Zakah on Salam capital if the goods have been purchased for trading purposes. When the goods are purchased for operating or income generating purposes the rulings indicated in item 4/1 and 4/2 should be applied. As regards the Salam capital received by the seller of the goods, such income is subject to Zakah as part of the seller's cash assets.

5/3/4/11 Debtors of Istisna'a goods sold by the institution: This item represents the balance of amounts due to the Institution as per delivery dates of the Istisna'a commodity. Such amounts are part of Zakatable assets, and Zakah has to be paid on them under the category of current assets, because they constitute cash amounts.

5/3/4/12 Debtors of Istisna'a goods purchased by the institution: When such goods are purchased for the sake of trading, the debt relating to them (the price which the Institution is committed to pay to the seller) should be included in zakatable assets, and subjected to Zakah as per item 5/3/1.

5/3/4/13 Investment in shares for the sake of trading: Should become subject to the Zakah rate applicable to articles for trade. Valuation has to be at market price, yet in the absence of any market for such shares, valuation can be made by experts.

5/3/5 Debtors in an insurance portfolio

As indicated in the Shari'ah standard on Islamic Insurance the contributions of policyholders constitute a fund which has an independent financial liability, and the contributor is supposed to have given the premium as a donation. Consequently, the insurance fund is not committed to pay back any excess amounts to policyholders [items 2 and 5/5 of the Shari'ah Standard No.

(26) on Islamic Insurance]. In view of this no Zakah is payable by the insurance portfolio.

5/4 Zakah on agricultural produce and fruits

5/4/1 The *Nisab* for agricultural produce and fruits is 653 kilograms. No consideration should be given to the *Hawl* (Zakah year) because what matters here is harvesting. The applicable Zakah rate is one tenth (10%) for the produce of non-irrigated lands, half of the tenth (5%) for the produce of irrigated lands, and three quarters of the tenth (7.5%) for the produce of partially irrigated lands.

5/4/2 In calculation of the *Nisab* different types of the same kind of produce can be added together, such as the different types of the same kind of grain or fruit, whereas different kinds of produce or fruits cannot be added together. Each kind of produce or fruit should have its separate *Nisab*. It makes no difference when the agricultural produce or fruits owned by the same Institution or company are in different geographical locations.

5/4/3 *Khars* (estimation by experts) can be adopted when the agricultural products or fruits are ripe. One fourth or one third can be deducted and left to the owner and the rest becomes subject to Zakah on the basis of *Khars* after the produce is dried. Zakah can also be paid in terms of value.

5/4/4 Works under implementation (constructions) relating to agriculture are not part of Zakatable assets.

5/4/5 Production requirements such as fertilizers and insecticides are not part of zakatable assets, and should not be deducted from the Zakah base unless they have been obtained through debt.

5/4/6 Rapping and packing materials are not part of zakatable assets.

5/4/7 Expenses relating to irrigation, land development, irrigation channels and soil woks shall not be deducted from zakatable assets.

5/4/8 Cost of delivery to recipients shall be deducted from zakatable assets.

5/4/9 Zakah on the produce of a rented agricultural land should be paid by the tenant. In case of Muzara'ah or Musaqat, Zakah shall be paid by the two parties proportionately.

5/4/10 Subsidies and concessions related to agriculture: Cash subsidies shall be included in the Zakah base as part of liquid assets subject to item 5/3/1, whereas free-of-charge land and equipment should not.

5/5 Zakah on minerals

5/5/1 Minerals here include all stuffs of this kind extracted from the earth or the sea whether in liquid, solid or gaseous form.

5/5/2 The *Nisab* for minerals is what has reached in value 85 kilograms of gold. *Nisab* is to be assessed for quantities extracted continuously. If extraction is suspended for an abnormal period assessment of *Nisab* shall start at the time when extraction is resumed again. The Zakah rate applicable to minerals is 2.5%. If the extracted minerals are owned by the state no Zakah shall be paid on them, otherwise minerals are the property of their extractor, and he should pay Zakah on them. [see Shari'ah Standard No. (22) on Concession Contracts]

5/5/3 Pearl, coral and fish extracted from the sea for trade should become subject to the Zakah rate applicable to articles of trade.

5/6 Zakah on livestock

Nisabs and Zakah rates for livestock (camels, cows and goats) are shown at the end of this standard. Livestock that reaches the *Nisab* is subject to Zakah, whether owned for milk or progeny. The animals shall become subject to the Zakah rate on livestock, only if they are fed through free grazing, most of the year. If the animals are owned for trade they shall become subject to the Zakah rate on articles of trade.

5/6/1 It makes no difference if the animals which belong to the same owner are found in the same place or different places. Mixed ownership can also be recognized so that the animals owned by more than one person are treated as if they are owned by a single person, when such animals share the same facilities.

5/6/2 Animals owned for trade should become subject to the Zakah rate on articles of trade. Valuation has to be at selling market price.

5/6/3 Working animals, such as animals used in land plowing, irrigation and carrying are not part of zakatable assets.

5/6/4 Animals other than camels, cows and goats are not subject to Zakah payment, unless they are owned for trade. If such animals are used for production rather than trade they should not be included in zakatable assets.

5/6/5 When animal products such as milk and wool are owned for trade they should become subject to Zakah on articles of trade.

5/6/6 Zakah is not payable on horses, mules, donkeys and all other animals used for work or adornment, unless owned for trade.

5/6/7 Zakah is not obligatory on chickens acquired for production, which should be treated in the same way as Mustaghallat (productive assets such as leased properties). [see item 4/2]

5/6/8 Chickens, milk and stocks of animals are subject to Zakah on articles of trade when they are owned for trade purposes.

6. Liabilities

6/1 Classification of liabilities

Liabilities in financial statements comprise items which are not debts owed by the Institution in the strict sense of Shari'ah. Such items include for instance the capital of the company, the reserves and the profits. The debts included under the item of liabilities comprise the following:

6/1/1 Non-current (long term) liabilities which refer to debts that become due after one year. Such debts usually arise from purchase of fixed assets on debt, in addition to other long term entitlements.

6/1/2 Current (short term) liabilities which refer to debts that become due within one year.

6/2 Debts owed by the institution

6/2/1 If the debts owed by the Institution have arisen from obtaining current zakatable assets for the purpose of trade they should be deducted from the Zakah base.

6/2/2 If the debts owed by the Institution have arisen from obtaining non-zakatable fixed assets, they should not be deducted from the Zakah base.

6/2/3 When it is difficult to know the amount of debt that has arisen from acquiring zakatable assets, the ratio of zakatable assets to total assets should be used for assessment of such debt which has to be deducted from the Zakah base. If, for instance, zakatable assets constitute 40% of total assets, 40% of total debts should be deducted from the Zakah base.

6/2/4 If the debt owed by the Institution has arisen from a Shari'ah-banned practice such as borrowing with interest, unpaid interests should not be deducted from zakatable assets, because impermissible commitments cannot lead to a Shari'ah-recognizable debt.

6/3 Applications relating to current liabilities in the items of financial statements

6/3/1 Current accounts: The balances of current accounts should be deducted from the zakatable assets of the Institutions with which such accounts are deposited. Similarly, the principal as well as the profits of investment accounts should be deducted from the zakatable assets of the Institutions entrusted with investing these accounts to the benefit of their holders. In the case of investment accounts the share of the Mudarib or agency fees earned by the Institution shall be excluded from the deductable amount.

6/3/2 Creditors: This item refers to the amounts payable to the creditors of the institution during the Zakah year. Such amounts which usually arise from obtaining goods, equipment, or services on debt should be deducted from zakatable assets.

6/3/3 Creditors of sold goods of Salam: It refers to those who purchased goods from the Institution through Salam and have not yet received them. The goods constitute a debt, because they have not yet been delivered, and therefore, the amount of Salam capital should be deducted from the zakatable assets.

6/3/4 Creditors of sold goods of Istisna'a: The goods constitute a debt because the Institution has entered in a commitment to make them, and it is yet to do so. Hence, such goods shall become subject to the rulings indicated in item 6/3/6.

6/3/5 Creditors of purchased goods of Istisna'a: This indicates the debt commitment of the Institution when it purchases goods through Istisna'a. The balance of this item should be deducted from Zakatable assets.

6/3/6 Payment papers: It includes bills and order bonds issued to importers of deferred goods and services, or bills and order bonds issued for interest free borrowing; if such papers will fall due in the next Zakah year. Such assets should be deducted from zakatable assets.

6/3/7 Short term loans and overdraft accounts shall be subject to the rulings indicated in item 6/3/2.

6/3/8 Accrued expenses: It is the expenses which relate to the current period and is to be paid during the next period. Such expenses should be deducted from zakatable assets.

6/3/9 Prepaid income: If such income relates to services which have not yet been provided no Zakah has to be paid on the exact portion of it which relates to the undelivered services; because such income is not finally owned, and the Ijarah (hiring) contract for provision of the services could be terminated on occurrence of an excuse or a *force majeure* situation. Consequently prepaid income for undelivered services should be deducted from zakatable assets.

Nevertheless, cash amounts of earnest money forwarded on conclusion of written or verbal exchange-based (Mu'awadah) contracts are considered to be owned by the Institution or the company, and Zakah has to be paid on them even if the goods in question have not been delivered. That is to say such amounts should not be deducted from zakatable assets.

6/3/10 Due taxes: Tax amounts that relate to the current period, but has to be paid in the next period should be deducted from zakatable assets.

6/3/11 Security amounts paid by clients to guarantee fulfillments of their commitments and settlement of periodical bills should be deducted from zakatable assets.

6/3/12 Minority rights which refer to other shareholders' equity in the subsidiary, and which appear in the consolidated financial statements should become subject to the rulings indicated in item 4/2/5.

7. Provisions

7/1 Definition of provisions

Provisions represent the amounts retained from revenues at the end of the financial period so as to cater for probable shortage of assets, or to meet imprecisely determined or unforeseen commitments of the Institution. Since provisions are estimates of probable loss amounts and unspecified commitments, they have to be totally or partially returned back to the profit and loss account (income statement), if the debt is collected or the commitment is fulfilled, or if the provision amount is more than it should have been.

7/2 Classification of provisions

Regarding provisions, the following should be observed:

7/2/1 Provisions relating to fixed assets: Such provisions are nondeductible from Zakah assets, since fixed assets are not part of the Zakah base.

7/2/2 Provisions relating to current assets: Since Zakah is calculable on the basis of market value, provisions relating to current assets are not considered as part of liabilities to be deducted from zakatable assets. If, for any reason, current assets are valued for Zakah calculation at book value which happens to be more than exchange value, the difference between book value and market value pertinent to provisions should be deducted from Zakatable assets.

7/2/3 Provisions relating to liabilities: Liability provisions which aim to cover imprecisely determined commitments of the company such as provisions for: end of service benefits, staff leaves, taxation, and indemnities, shall be reasonable so as not to become secret reserves. Whenever exaggeration in such provisions is discovered, the excess amount should be removed.

7/2/4 In the cases when the provision is deductable from assets interest should not be deducted if it happens to be involved in it. Deduction from assets in this case should include only the Shari'ah-recognizable commitment. It should, however, be noted that interest bearing deposits and loans are strictly prohibited by Shari'ah. [see item 6/2/3]

7/3 Applications relating to provisions

7/3/1 Provision for redemption of pre-operating expenses: It is the cumulative amount of the redeemed part of pre-operating expenses. This provision is not deductable from zakatable assets.

7/3/2 Provision for deterioration in the value of investments in shares purchased for acquisition: This provision is meant to cater for price decline in financial markets, or book value, below cost; in case of valuation at cost or market value whichever the less. Such provision is not deductable from zakatable assets.

7/3/3 Provision for perishable or slow moving goods: In case of slow moving goods the provision is to cover probable declines in value due to expiry, obsolescence of type, or slow marketing. This provision is not deductable from zakatable assets.

7/3/4 Provision for probable declines in the prices of goods or financial papers: This provision is usually made to cater for declines which actually take place, and it is not deductable from Zakatable assets.

7/3/5 Provision for leaves: It is the amount deducted from revenues so as to cater for the commitment of the institution to compensate staff for leave entitlements. This provision is not deductable from Zakatable assets.

7/3/6 Provision for end of service and retirement benefits or pension salary of staff: It refers to the amounts deducted from revenues for meeting payment of such obligations. Such amounts are not deductable from Zakatable assets because they are allocated for disbursement, but not yet disbursed. They can be deducted only when they are actually paid or when they become due for payment during the current year, but not yet settled.

7/3/7 Provision for indemnity: It refers to the estimated amounts deducted from revenues in order to cater for a confirmed commitment relating to an initial legal verdict (before appeal) stipulating the payment of a specific amount as indemnity to a certain party. Such provision is estimated according to the amounts mentioned in the verdict, and it should not be deducted from Zakatable assets until it becomes due for payment by virtue of a final verdict.

7/3/8 Provision for maintenance: It is an amount allocated for spending, but not yet spent. It is not deductable from Zakatable assets.

7/3/9 Provision for insurance of fixed assets: This provision refers to the amounts charged to the revenues of the company to substitute the premiums that will be paid to insurance companies. This provision is estimated as per the amounts of its components. It should not be deducted from Zakatable assets because it comprises amounts that have been allocated for spending, but still owned by the company.

7/3/10 Provision for decrease in the price of currencies: It is the amount charged to the revenues of the company to cater for probable decline of the prices of foreign currencies against the price of the currency used in the financial statements of the company. It is assessed on the basis of the difference between the two prices (purchase price and market price). Such provision is not deductable from zakatable assets, because what matters is the prevailing exchange price at the time of valuation of Zakatable assets.

7/3/11 Provision for taxes: It refers to the estimated amounts deducted from the revenues of the company for settlement of the unpaid taxes of the current year. Such provision is assessed according to size of activity during the current financial period, besides the tax level in the previous financial periods. This provision is not deductable from Zakatable assets.

8. Reserves

8/1 Definition of reserves

Reserves are amounts deducted from profits by virtue of law (statutory reserves), or as required by articles of association of the Institution, or on the basis of a decision by the general assembly (voluntary reserves). Reserves provide necessary funds for many purposes such as future expansion, facing probable losses, distribution of profits in the years when no profits are realized, and distribution of the accumulated amounts of the reserves when they are no longer needed.

8/2 Nature and Shari'ah status (Hukm) of reserves

8/2/1 Both types of reserves (statutory and voluntary) are not deductable from zakatable assets, because in Shari'ah they are not considered to constitute debt obligations owed by the company, although it is referred to under liabilities. Since reserves are owned by the company they should be subject to Zakah as part of Zakatable assets, in case of applying the net assets method of Zakah assessment.

8/2/2 In spite of the fact that the capital account and the issuance premium provide sources of funding for the company they are not considered to be part of its debt obligations, even if capital is usually referred to under liabilities. Therefore, capital account and issuance premium are not deductable from Zakatable assets.

8/3 Applications relating to reserves

8/3/1 Revaluation reserve (capital reserves): It results from revaluation of fixed assets at current market value, and since fixed assets are not subject to Zakah, such reserve is not deductable from Zakatable assets.

8/3/2 Income reserve: It refers to that part of distributable profit which is retained by an administrative decision in provision for future need. It is not a debt obligation owed by the Institution, and therefore should not be deducted from Zakatable assets.

8/3/3 Reserve of profits earned from share purchasing operation (institution's treasury shares): This reserve results from the act of the Institution when it purchases and sells its own shares. It is not deductable from Zakatable assets, since it is part of the profits.

8/3/4 Reserve of profits declared for distribution: It refers to the profit declared by the board of directors, but the decision for its distribution has not yet been taken.

8/3/5 Reserve of retained profits: This reserve comprises the profits earmarked for transference to forthcoming years. It constitutes one type of income reserves, and is not deductable from Zakatable assets.

9. Eight Heads of Zakah Disbursement

The heads of Zakah disbursement are the eight categories specified by the Verse which states: ***{"As-Sadaqat (here it means Zakat) are only for the Fuqara' (poor), and Al-Masakin (the poor) and those employed to collect (the funds); and for to attract the hearts of those who have been inclined (towards Islam); and to free the captives; and for those in debt; and for Allah's Cause (i.e., for Mujahidun - those fighting in the holy wars), and for the wayfarer (a traveller who is cut off from everything); a duty imposed by Allah. And Allah is All-Knower, All-Wise."}***[(4)] Shari'ah Supervisory Boards of the institutions may specify the meaning and appropriate way of application, for each one of these categories.

10. Rulings Relating to Zakah Disbursement

10/1 The Zakah payer (institution) cannot discharge of his Zakah commitment by relieving his debtors from their debt obligations. This, however, does not mean that Zakah recipients cannot repay their debts out of the Zakah amounts which they receive from their creditors, provided that such arrangement does not involve collusion or a pre-stated condition.

10/2 In principle, Zakah is to be paid as soon as it is due, yet it can be delayed - for not more than one year – due to shortage of funds, or if its distribution is made according to a certain time schedule, or for any other obvious interest.

10/3 Institutions should establish a special fund or account for Zakah.

10/4 In principle, Zakah should be spent on its eight heads, yet if need arises Zakah funds can be utilized in investment projects.

(4) [Al-Tawbah (Repentance): 60]

However, such projects should, at the end, be owned by the Zakah recipients, or put under the supervision of the competent Shari'ah body entrusted with collection and distribution of Zakah. Nevertheless, investment of Zakah funds should be after fulfilling the urgent needs of Zakah recipients, and on availability of sufficient safeguards against losses.

10/5 Zakah does not cease to be valid by prescription.

10/6 Zakah can be paid before its due time, subject to specific conditions on which Shari'ah boards should be consulted.

10/7 Zakah can permissibly be paid in terms of the equivalent value of the subject commodity.

10/8 Zakah should not necessarily cover all the eight heads of its disbursement. It can permissibly be confined to some of them.

10/9 Zakah funds can be transferred from place of payment to another place due to an obvious interest to be judged by the Shari'ah boards of the institutions.

11. *Nisab* and Zakah Rate for Livestock (An'am)

11/1 *Nisab* and Zakah rate on camels

From	To	Obligatory Zakah Rate
1	4	Nothing
5	9	1 goat
10	14	2 goats
15	19	3 goats
20	24	4 goats
25	35	Bint Makhad camel (at the second year of age)
36	45	Bint Labun camel (at the third year of age)
46	60	Hiqqah camel (at the fourth year of age)
61	75	Jaza'ah camel (at the fifth year of age)
76	90	2 Bint Labun
91	120	2 Hiqqah
121	129	3 Bint Labun
130	139	1 Hiqqah + 2 Bint Labun
140	149	2 Hiqqah + 1 Bint Labun
150	159	3 Hiqqah
160	169	4 Bint Labun
170	179	1 Hiqqah + 3 Bint Labun
180	189	2 Hiqqah + 2 Bint Labun
190	199	3 Hiqqah +1 Bint Labun
200	209	4 Hiqqah or 5 Bint Labun
210	219	1 Hiqqah + 4 Bint Labun
220	229	2 Hiqqah + 3 Bint Labun
230	239	3 Hiqqah + 2 Bint Labun
240	249	4 Hiqqah + 1 Bint Labun
For more than 249, one Hiqqah for every 50 camels and one Bint-labun for every 40 camels.		

11/2 *Nisab* and Zakah rate on cows

From	To	Obligatory Zakah Rate
1	29	Nothing
30	39	Tabee'a or Tabee'ah (at 2nd year of age)
40	59	Musinnah (at 3rd year of age)
60	69	2 Tabee'a or 2 Tabee'ah
70	79	Musinnah + Tabee'a or Tabee'ah
80	89	2 Musinnah
90	99	3 Tabee'a or 3 Tabee'ah
100	109	Musinnah + 2 Tabbee'a or 2 Tabee'ah
110	119	2 Musinnah + Tabee'a or Tabee'ah
120	129	3 Musinnah or 4 Tabee'a or 4 Tabee'ah
For more than 129, one Tabee'a or one Tabee'ah for every 30 cows and one Musinnah for every 40 cows.		

11/3 *Nisab* and Zakah rates on goats

From	To	Obligatory Zakah Rate
1	39	Nothing
40	120	1 goat
121	200	2 goats
201	399	3 goats
400	499	4 goats
For more than 499, one goat for every 100 goats.		

12. Date of Issuance of the Standard

This Standard was issued on 30 Dhul-Qa'dah 1429 A.H., corresponding to 28 November 2008 A.D.

Adoption of the Standard

The Shari'ah Board adopted the draft of the Standard on Zakah in its meeting No. (22) held in the Kingdom of Bahrain on 28–30 Dhul-Qa'dah 1429 A.H., corresponding to 26-28 November 2008 A.D.

Appendix (A)
Brief History of the Preparation of the Standard

In its meeting No. (13) held on 26-30 Sha'ban 1425 A.H., corresponding to 10-15 October 2004 A.D., in Makkah Al-Mukarramah, The Shari'ah Board decided to issue a Shari'ah standard on Zakah.

On 1 Ramadan 1425 A.H., corresponding to 16 October 2004 A.D., the Secretariat General decided to commission a Shari'ah consultant to prepare a study on Zakah.

A joint committee composed from Shari'ah Committees (1) and (2) was held on Thursday 8 Rabi' I, 1427 A.H., corresponding to 6 April 2006 A.D., in Makkah Al-Mukarramah. In that meeting the committee discussed the study, cleared it, and asked the consultant to introduce necessary changes in the light of the observations and suggestions made in the meeting.

In its meeting No. (17) held in Makkah Al-Mukarramah, on 26 Shawwal – 1 Dhul-Qa'dah 1427 A.H., corresponding to 18-23 November 2006 A.D., the Shari'ah Board discussed the amendments made by the joint committee and introduced the changes that it deemed necessary.

The Secretarial General of AAOIFI held a public hearing in the Kingdom of Bahrain on 18 Safar 1428 A.H., corresponding to 8 March 2008 A.D. More than 30 participants attended the session as representatives of central banks, institutions, and accounting firms. The session was also attended by Shari'ah scholars, university teachers and other interested parties. Several observations were made in the session, and duly responded to by the members of the Shari'ah Standards Committees (1) and (2).

In its meeting No. (18) held on 12–16 Jumada II, 1428 A.H., corresponding to 27 June – 1 July 2007 A.D., in Al-Madinah Al-Munawwarah, the

Shari'ah Board discussed the amendments proposed by the public hearing, and introduced the changes that it deemed necessary.

In its meeting No. (20) held in the Kingdom of Bahrain, on 4-8 Safar 1429 A.H., corresponding to 11-15 February 2008 A.D., the Shari'ah Board discussed the changes introduced by the joint meeting of Shari'ah Committees (1) and (2), and introduced necessary changes.

In its meeting No. (22) held in the Kingdom of Bahrain, on 28-30 Dhul-Qa'dah 1429 A.H., corresponding to 26-28 November 2008 A.D., the Shari'ah Board adopted the Standard after discussing it and introducing necessary changes.

Appendix (B)
The Shari'ah Basis for the Standard

It is impossible to imagine a debt arising from commodities purchased through Salam, because the capital (price) has to be paid in advance. The Salam buyer has to pay Zakah on the Salam capital which he receives.

Appendix (C)
Definitions[5]

Method of Net Investment Assets

Paid-up Capital + Reserves + Provisions which have not been deducted from assets + Retained Profits + Net Income + Liabilities which are not payable during the current financial period as at the date of the Balance Sheet + Total installments of the coming financial period + net fixed assets and additional investments which are not for trade such as real estate for leasing + carried forward losses.

(5) For easy reference, most of the terms have been defined in the text of the rulings indicated in this standard.