

## **Zakat as a Measure of Social Justice in Islamic Finance : An Accountant's Overview**

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### **Abstract**

Zakat is an important form of religiously mandated charity under Islam. It is the third pillar of Islam. The giving of Zakat is important for Muslims, as this leads to purification of their wealth from all sins. This paper examines the role of Zakat as an instrument of social justice and poverty eradication in society. Each Muslim calculates his or her own Zakat individually. Generally, this involves the payment each year of two and a half percent of one's capital, after the needs of the family have been met. One can donate additional amount as an act of voluntary charity but Zakat is fundamental to every Muslim. Zakat is the Islamic contribution to social justice: those who have to give charity share the benefit of their prosperity to those who have fallen short. This is the Islamic approach to remove greed and envy and to purify one's soul based on good intentions. This is the institution of Zakat in Islam. The institution of Zakat serves to eradicate poverty in the community and uphold the light of Islam. Allah says “whatever is paid as Zakat for the sake of Allah shall be rewarded in manifold”.

*Keywords : Zakat, Islam, Social Justice, Prosperity, Institution*

### **1. INTRODUCTION**

Muslim countries are now attempting to align their economies to accord with the tenets of Islam. Having five fundamental duties called the Pillars of Islam, Zakat is the third pillar. Giving of Zakat is important for Muslims, as this leads to purification of wealth. Setting aside a proportion for those in need purifies an individual's wealth and possessions. Therefore, the act of giving Zakat means purifying one's wealth to gain Allah's blessing,

as mentioned in the Quran that a person who refuses to pay Zakat could attract severe condemnation and judgements.

Due to the current state of unemployment, this situation is made worse as many university graduates have failed to secure gainful employment. We are faced with a community of debt-ridden, incomplete education amongst children and living in poverty and distress. In Islam, poverty is an enemy that must be eradicated and prevented in order to preserve the sanctity of the religion and to uphold the dignity of the *ummah*. Poverty has adverse repercussions on mankind as it weakens the society. Prophet Muhammad (pbuh) has mentioned, "Hunger nearly leads to infidelity and all sorts of wrong doings". Thus, Islam rejects all forms of poverty, in line with Allah's command that Zakat being the third pillar of Islam enables the obligation of His servant to share their wealth. Without a complete systematic institution of Zakat, our community will be disabled. As such, the collection of Zakat brings tremendous benefits to those who give and those who receive.

The present paper attempts to highlight the fact the Zakat is a way of social justice and is able to harness its beneficiaries to become productive contributors to the development of the community. The paper is based on the principle that everything belongs to Allah (God), and wealth is entrusted upon the *ummah*. Based on the Quran and existing literature on the subject, this paper delves into six sections namely the introduction, the conceptual aspects, the different types of Zakat as well as the significance and accountability of Zakat.

## **2. CONCEPT OF ZAKAT**

Zakat is monetary devotion based on the idea that all things belong to Allah (God), and that wealth is therefore positioned at the disposal of mankind as a trust. The passion of human beings is sanctified through earmarking a proportion of the wealth for the distressed and needy as mandated in the Quran. Zakat does not only purify the property, but also purifies one from selfishness and greed. The recipient of Zakat also purifies

himself from envy, jealousy, hatred and uneasiness as it will foster goodwill, gratefulness and warm wishes for the contributors.

With regards to the society, Zakat signifies a major economic means for establishing social justice, which will lead to prosperity and security. Zakat is obligatory for every adult, mentally stable, free and financially able Muslim as mentioned in the Quran:

*“The alms are only for the poor and the needy, and those who collect them, and those whose hearts are to be reconciled, and to free the captives and the debtors, and for the cause of Allah, and (for) the wayfarers; a duty imposed by Allah. Allah is knower, Wise.”* (At-Taubah 9: 60)

### **2.1 Obligations of Zakat**

According to the Islamic law, a person who fulfills the following criteria holds the obligation to pay Zakat:

- A Muslim
- Adult, sane, free (not a slave)
- He or she must possess a certain minimum amount of extra wealth (called *nisab*)

### **2.2 Exemptions from Zakat**

Zakat is not obligatory if the amount owned is less than this *nisab*, fully owned by the person in excess of personal use:

- The person should have had the minimum amount in possession for a complete lunar year (*hawl*)
- The wealth or profit should be of a productive nature, from which they can derive profit or benefit such as merchandise for business, gold, silver, livestock
- The minimum amount (or *nisab*) should not be owed to someone, that is, it should be free from debt

### **2.3 People who are entitled to receive Zakat**

Zakat is distributed among 8 main categories of *Asnaf* (beneficiaries) of people, namely:

- *Fakir* - has neither material possessions nor means of livelihood
- *Miskin* – has insufficient means of livelihood to meet basic needs
- *Amil* – has been appointed to collect and do the management of Zakat
- *Muallaf* – has converted to Islam with purpose to keep their faith
- *Riqab* - wants to free himself from bondage or the shackles of slavery

- *Gharmin* - is in debt (money borrowed to meet basic, *halal* expenditure)
- *Fisabilillah* - fights for the cause of Allah
- *Ibnus Sabil* – in a journey, provided that the destination of the journey is not against *Syara*

### 3. TYPES OF ZAKAT

Zakat is divided into two main categories namely:

#### (i) Zakat *Fitrah*

Zakat *Fitrah* is an obligation upon all Muslims, which must be paid at the end of *Ramadan* before observing the *Eid* prayer. The required amount of Zakat is approximately 3 kg of staple food in the relevant country or an amount of money that is equivalent to the price of the food.

#### (ii) Zakat *Al-Mal* or Zakat for Wealth and Possessions

The Zakat on wealth and possessions are classified into:

- Zakat for Income and Salary
- Zakat for Business
- Zakat for Savings
- Zakat for Stocks
- Zakat for Gold and Silver
- Zakat for Agriculture and Poultry

#### 3.1 Zakat for Income and Salary

The fundamental calculation for Zakat on wealth and possessions is called *nisab*. Zakat for salary and income is compulsory on income or pay as return to the job or services done by an individual. The income includes salary, bonus, dividend, royalties, allowances, commissions, pensions, compensations and other forms of earnings. There are two methods of calculations for zakat on salary and income:

- (i) Annual Gross Income x 2.5% (if the amount exceeds *nisab*)
- (ii)
- |  |    |    |
|--|----|----|
| Income that is applicable for Zakat x 2.5%             |    |    |
| Annual Gross Income                                    | ** |    |
| Less: Annual Expenses                                  | ** |    |
| Income applicable for Zakat (if exceeds <i>nisab</i> ) | —  | ** |
| Zakat @2.5% on income applicable for Zakat             | —  | ** |

**Example of Zakat for Income and Salary:**

Mr. Z.A. Hossain receives the following emoluments during the financial year 2009 - 2010.

Basic pay	Rs.	300000
Dearness allowance	Rs.	150000
Commission	Rs.	40000
Entertainment allowance	Rs.	10000

His basic annual expenses are:

Personal expenses	Rs.	80000
Expenses for spouse	Rs.	45000
Children (@Rs.25000 p.a. for two children)	Rs.	50000

Taxations and other obligations	Rs.	25000
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Determine the Zakat amount for Mr. Hossain in the financial year 2009-2010. Rate of Zakat is 2.5%.

Computation of Zakat amount of Mr.Z.A.Hossain for the financial year 2009-2010.

<u>Item</u>	<u>Amount (Rs.)</u>	<u>Amount (Rs.)</u>
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**Annual Sources of Income**

Basic Salary	300000	
Dearness allowance	150000	
Commission	40000	
Entertainment allowance	<u>10000</u>	500000

**Annual Basic Expenses**

Personal expenses	80000
Expenses for spouse	45000
Children's expenses (2 x 25000)	50000
Taxation paid	<u>25000</u>

Income that is applicable for Zakat  
(exceeds *nisab*)

**Zakat amount (Rs.300000 x 2.5%)**

**Rs.7500**

Notes:

- (i) There is no standard calculation of *nisab* i.e. the amount of basic expenses for the family.
- (ii) Payment of Zakat in India is purely voluntarily as individuals are liable to pay taxes to the concerned authorities.
- (iii) The rate of Zakat is uniformly 2.5% all over the world.
- (iv) Some Islamic countries have collected Zakat and expenses for their poverty alleviation programmes.
- (v) Rs.53.6 = USD1 (based on the rate of exchange on 30 Jan 2013)

### **3.2 Zakat for Business**

Zakat for business is obligatory on wealth generated by businesses. It includes all kinds of business such as sole trader, private limited, limited company, partnership business, and cooperatives.

### **3.3 Rate for Zakat**

2.5% is on the business wealth and possessions according to *nisab*.

### **3.4 Method of calculation**

#### **a) Method-I**

Working Capital [Current Assets – Current Liabilities] x Share owned by Muslim x 2.5%. The method is used for companies that owned stated current assets and current liabilities for example, private limited, limited and cooperatives.

#### **b) Method- II**

The following method is used for financial institutions and Islamic banking which has no specific current assets and current liabilities:

Working Capital [Owners Equity + Long-term Liabilities - Fixed Assets – Semi-Fixed Assets] x % of share owned by Muslim x 2.5%

### **3.5 Zakat for Savings**

Savings is considered obligatory for Zakat once it reaches *nisab* of one year and the amount exceeds the *nisab*, which is equivalent to the current value of 85 gram of gold. The rate is 2.5% from the amount of savings. For the savings in the account, if a person's savings has reached one-year length of time, where its lowest balance (minus the interest during the time of savings) exceeds *nisab*, then the person is obligated to pay for the Zakat as savings.

### **3.6 Zakat for Gold and Silver**

For gold that is used for women accessories on their bodies, Zakat is not obligatory if the value or weight of the gold does not exceed a certain limit (*urf*). The *urf* varies from country to country. If the gold is placed as savings or not used as accessories, the gold is obligatory for Zakat @2.5% if it exceeds the *nisab* of 85 grams.

For silver, the amount to be obligatory for Zakat is calculated based on the value of the silver regardless of its condition whether as accessories on the body or at home or is placed as savings. *Nisab* for silver is 595 gram or more.

### ***3.7 Zakat for Shares/Stocks***

General guidance for Zakat calculation is 2.5% on the lowest value of the whole shares or stocks that are owned for a year after deducting the amount of loan made for the purchase of the stocks (provided if the stocks are purchased by loan).

For the shares that the owner still owns until the end of *haul*, the Zakat calculation is 2.5% based on the lowest cost / market price. For the share that is under the process of sale and purchase for a whole year / *haul*, the calculation is 2.5% based on the selling value after purchasing cost deduction.

### ***3.8 Zakat for Agriculture and Poultry***

Zakat for agriculture is made on the agriculture produces that are the basic food for a country once it has reached the *nisab* and *haul*. In India, the citizen's basic food is rice, so the production of paddies becomes obligatory for Zakat. Islamic agents determine the rate or percentage of amount to be paid for Zakat where the agriculture product is produced.

Zakat for poultry is obligatory once it reached the term and conditions for the owners, applicable on types of animals that are obligatory for Zakat. The types of animals are goat, sheep, cow, buffalo and camel.

## **4. SIGNIFICANCE OF ZAKAT IN ISLAMIC FINANCE**

Essentially Zakat ranks next in importance only to prayers as a feature of everyday witness to the Islamic faith. It is an integral, compulsory and inseparable part of the Islamic way of life, the non-observance of which is tantamount to the negation of the religion itself (Ashaari and Mohamed, 1989). Zakat covers the moral, social and economic spheres of Islamic finance (Mannan, 1986). In the moral sphere, Zakat washes

away the greed and acquisitiveness of the rich, whilst socially, it acts as a unique measure to abolish poverty from society as well as encouraging the rich to live up to their social responsibilities (Mannan, 1986).

The Quran categorically states this:

*And those in whose wealth are a recognized right. For the needy who asks and him who is prevented (for some reason from asking) (Al-Ma`arij 70: 24-25)*

From the economic point of view, Zakat prevents the morbid accumulation of wealth in a few hands and allows it to be more widely distributed. Mannan (1986) reiterates that the payment of Zakat should be voluntary and for genuine social motives because Zakat payment is symbolic of the inner unity of religion and economics. However, Zakat cannot be regarded as a favour that the givers do for their fellow Muslims.

Gambling and Karim (1991) contend that one of the major objectives of accounting in an Islamic society is to provide information to enable the individual to determine his Zakat liabilities as specified in the Shari'a. It is the individual owners who are responsible for determining the amount that should be paid out as Zakat. Another issue that has been the subject of considerable debate amongst Islamic jurists is whether or not a company is liable for Zakat. This was resolved at the Zakat conference in Kuwait in 1985. The conference agreed that in the case of a company considered as a separate legal entity, Zakat should be determined based on the company's net current assets as if the company is subject to Zakat. The Zakat so determined would then be divided between the owners for the purpose of each owner satisfying his religious obligation by himself. However, in the following four cases, Islamic jurists have come to a consensus that a company would be required to satisfy the Zakat obligation itself, either as an entity or on behalf of its owners under the following conditions:

- when the company is required by its charter or by-laws to satisfy the zakat obligation as an entity
- when the general assembly of shareholders passes a resolution requiring the company to satisfy the zakat obligation as an entity
- when individual owners authorize the company to act as their agent satisfying the zakat obligation (SFAC 1, p29)

Although voluntarism is encouraged in Islam, if an individual does not pay Zakat, the state has the power to enforce payment so that social justice prevails. Islam gives preference to the rights of the community over the individual. Thus, the government has to play a major role in an Islamic society. If the general interest of society is unduly harmed, the state has the authority to interfere (El-Ashker, 1987; Chapra, 1992). According to the Quran, the importance of Zakat can be summarized in the following points:

- Zakat is a test from Allah *swt* upon the wealth given to us
- Zakat is obligatory on *Ummahs* (followers) of all prophets
- Zakat indicates the level of faith of a Muslim
- It is the foundation of Islamic fraternity
- It also acts as a sign of believers in ‘*salah*’ and ‘Zakat’. [‘*salah*’ is another pillar of Islam]
- It is the criteria for Allah’s help
- The defaulters of Zakat shall suffer the dooms of the day of resurrection

## 5. ACCOUNTABILITY OF ZAKAT

Zakat can be given directly to the beneficiary or it can be handed over to an institution. It is emphasized that it should only be given to those who have the right to receive it. As per the Pillars of Islam, “All Muslims agree that it was their duty to give Zakat to the *Imam* after his (the Messenger of God’s) death. For a time they (the commonalty) acted thus, until they saw how Zakat was seized and appropriated by their unjust *Imams*. Thus although they accepted them as their *Imams*, they withheld from them the Zakat of their properties, as far as was feasible.” Thus, questions arise regarding uses and misuses of Zakat fund. However, this was solved by the *qadis* (judges) in the following manner, “Now it is not the responsibility of the people with what they have been obligated to oversee that the Zakat is distributed in its places, because this obligation ceases after the payments have been made.”

Due to the manner of the collection and spending, Zakat became institutionalized from early times of the caliphates. Zakat may be treated as the taxes collected by modern governments for social welfare. In the modern Muslim world, Zakat has been left to the

individuals. However, in some Islamic countries, where the Sharia is strictly maintained, the government manages Zakat.

## 6. CONCLUSION

The Islamic social order is based on the principles of equality, justice, and brotherhood and the concepts of freedom and responsibility. Muslims must accompany the observance of his or her *salat* with the payment of Zakat, being an important component of Islam as established by the Quran. Additionally, financial reports should enable Muslims to determine Zakat liability and ultimately achieving socio-economic justice. Given this, and the emphasis on full disclosure, it is suggested that the current value balance sheet should be included as part of the reporting requirements of firms operating in an Islamic economy. Further, the financial accounting framework derived from the *Sharia* should be considered as part of the social and economic system of Islam, which ultimately leads to the goal of worshipping God in the way He has prescribed. The benefit of Zakat is immense as the entire society shall enjoy it and the public shall be free from crime and insanity. Allah *swt* says, "... whatever is paid as zakat for the sake of Allah shall be rewarded in manifold"

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