The Purification of Wealth

The Messenger of Allah, may Allah bless him and grant him peace, said: **"The one who pays *zakat* on his wealth, has purified his wealth"** – *Tabrani, Ausat, Ibn Khuzaimah*

Allah *subhana wa ta'ala* says in the Noble Qur'an: " And let not those who covetously withhold of that which Allâh has bestowed on them of His Bounty (wealth) think that it is good for them (and so they do not pay the obligatory *zakât*). Nay, it will be worse for them; the things which they covetously withheld shall be tied to their necks like a collar on the Day of Resurrection. And to Allâh belongs the heritage of the heavens and the earth; and Allâh is Well-Acquainted with all that you do." – *Aal 'Imran (3): 180*

Abdullah ibn Mas'ud, may Allah be pleased with him, has said, "We have been commanded to establish *salaat* and pay *zakat.* Whoever does not pay *zakat* his *salaat* too is not accepted." – *Tabrani, Isbahani*

Zakat on investment properties

As a general rule there is no *zakat* due on properties (both the land and the building). This is the case whether or not the property is empty and lying idle, or being used. It is also not relevant whether or not it is being used for personal reasons or for one's business. Therefore, even if a property is purchased with the intention of generating rental income then no *zakat* is due on the value of the property (though *zakat* will be due on the rental income - as cash once the rent is collected or as a trade receivable when payment from the tenant is due, even though it may not have been collected as cash yet). Even if the investor has the intention to sell the property at some point in the future, even then no *zakat* is due on the property as his primary intention is to generate rental income from the property.

On the other hand, if the investor's primary intention in buying the investment property is to sell it (usually within a short period of time) in order to make a capital gain, and <u>he goes into the transaction of buying the property with this intention</u>, then this property will be considered as part of his inventory. Hence, *zakat* will be due on the entire market value of the property. In such a case even if he rents out the property while he is searching for a buyer, even then *zakat* will be due. This is because his primary intention <u>at the time of purchase</u> was to resell it for a capital gain in the short term. Renting out the property was a secondary concern of the transaction. This situation applies to those who buy condominiums to resell soon after purchase and completion of the development. The same applies to those who buy foreclosed properties or those who buy houses to renovate it and sell it at a higher price. This also applies to builders who build houses from scratch. In that case *zakat* will be due on the value of the land and raw materials, until the house is completed, at which point *zakat* will be due on the market value of the constructed house.

If however the investor changes his mind and no longer intends to resell it, but rather uses it to generate rental income (though he does not have to completely rule out the possibility of selling it at some time in the future), then *zakat* will no longer be due on it, as it will no longer be considered as part of his inventory. Later if he decides to resell it, even then no *zakat* will be due on it, as prior to his decision to resell it, the investment property was being treated as a property for *zakat* purposes and not inventory.

Zakat on bonds

Full *zakat* is due on bonds even though the investment itself is impermissible. People often confuse the issue of there being no *zakat* on *haram* wealth with *haram* investments.

There is no *zakat* due on *haram* wealth. The entire amount has to be donated to the recipients of *zakat* with no intention of reward. The interest income earned from bonds has to be treated in this manner as interest is *haram.*

Bonds as an investment on the other hand represent a loan to another party. Even though the interest earned on this loan is *haram*, *zakat* is still applicable on the principal amount of the loan receivable from the borrower.

Zakat on Registered Education Savings Plans (RESPs)

RESPs are usually registered for one's children, though the subscribers (the one's contributing to the plan – usually the parents) still have control over the money they have contributed into the plan. They can withdraw the money from the plan any time they wish. Usually the funds in the RESP are returned to the parents if the children do not end up pursuing post-secondary education. Therefore if the parents intend that if the child goes to university then it will be given to them, however if they do not the parents will keep it (or take it back) for themselves, then in this case the RESP funds will be considered to belong to the parents as there is no definitive indication that it has been given over into the possession of their children. Hence *zakat* will be due on the funds in the RESP.

However if the parents truly intend that they have given this money over to their children, and have no intention of taking it back (in spite of being able to do so), even when the children do not end up going to university or college, then in this case no *zakat* will be due on them. However in this case *zakat* will have to be paid on the RESP funds by the children once they are *baligh* (mature).

With regards to the matching amount contributed by the government, no *zakat* is due upon it by the parents or the children as it has not been definitively given over into the possession of either of the parties. This amount is held in trust. If the children end up going to university then they can utilize the funds. If however they do not, or the parents prematurely withdraw the money from the plan, then the matching contribution will be taken back by the government.

Deductibility of deferred long term liabilities

The general rule regarding loans and liabilities is that all of it can be deducted from one's assets before calculating the *zakat* on those assets.

However *fuqaha* (Islamic legal jurists) have noted that if one does not intend or make effort to make immediate arrangements to pay off one's liabilities, but rather makes it his financial strategy to maintain loans and liabilities on a long term basis, then only the current portion of the loan (the amount due in the upcoming year) can be deducted from one's assets before calculating *zakat* (and not the entire amount of the loan). This applies to loans from banks to purchase houses on a mortgage, car financing arrangements, etc.

Impermissibility of deducting potential future taxes from RRSP and pension assets

The taxes payable on RRSP and pension assets upon withdrawal are not deductible for *zakat* purposes as they do not constitute legal liabilities in the *sharia'*. The existence of the liability is uncertain. Whether or not there will be a tax liability upon withdrawal, and if there is then the amount of the liability are all uncertain and is dependent upon the person's taxable income in the year the withdrawal is made.

Let us assume a person is at a 40% tax bracket his whole life. So he deducts 40% of the value of his *zakaatable* RRSP value each year before paying *zakat*. Now, in the actual year he withdraws the money let us say he does not have any income (because he was not working so he needed the extra money which he withdrew from his RRSP). Now let us assume that he only withdrew $10,000. He will end up paying no tax on that withdrawal as $10,000 is within the minimum amount on which no tax is due. How is it possible that every year he deducts an amount in anticipation of a liability which he never actually ends up paying?!

The truth is there is no actual liability but only a potential one. Let us explain when the liability actually arises. When someone withdraws money from a RRSP account there is a 20% withholding tax. Now if the person's actual tax bracket is below 20% that year he will get a refund. If it is higher than 20% then he will have to pay additional taxes based upon his tax bracket. This additional amount can possibly be deducted (but not necessarily) in the year of the withdrawal if he is certain of his tax bracket.

The characteristics of a liability are not present in potential future taxes. In the field of finance while doing a *financial* valuation of a person's net worth *finance* professionals will take into account future potential cash flows including future cash inflows from revenues and outflows from liabilities and expenses (such as future taxes). However these potential future occurrences are given no or very little credence by *accountants* and *lawyers*. In the same way in the field of *accounting* the statements might show that a person owns a certain asset but legally he does not (such as capital leases) or that one has a certain liability but *legally* there is no liability; the liability exists only according to *accounting* and *finance* (for example estimated bad debts and future potential taxes).

And even if we were to accept that the future potential taxes are an actual legal liability in the *sharia'*, even then such deferred long term liabilities are not deductible till the year (12 months prior to the date) it becomes due. Therefore the tax would not be deductible in any case till the year of withdrawal.

Zakat on retirement plans

Defined benefit pension plans: These retirement plans are now offered by very few large organizations or government agencies where the employee receives a certain fixed amount every month after retirement. Payment into the pension fund is made by both the employee or the employer or a combination of them both. In these cases, regardless of whether or not the contribution by the employee was voluntary or not there is no *zakat* on the assets in the fund. The assets are either owned by the employer or a third party asset management firm. However once the person starts receiving monthly pension there will be *zakat* o n the monthly payments he receives as per the regular rule of paying *zakat* on cash.

Defined contribution plans: In these retirement schemes the benefit the employee will receive monthly is not known with certainty. It depends upon how much assets are in the plan. Moreover the employee is the direct owner of the assets in the plan even though the employer also contributes a certain amount towards it. They can also withdraw the funds whenever they want. *Zakat* is due on the assets in such plans regardless of whether or not participation in these funds was voluntary or involuntary.

Note: RRSP is a type of defined contribution plan. The government provides tax breaks to individuals if they contribute towards retirement in a RRSP account.

Locked-in defined contribution plans: In certain defined contribution plans even though the employee is the owner of the assets in the fund, he does not have the right to withdraw it whenever he wants. If this is the case then no *zakat* will be due on the assets as long as the funds are locked-in as he lacks control over these assets, even though he has ownership.

Zakat on investments in stocks/shares

In many cases a person will buy a mutual fund which constitutes of several companies. It would not be permissible to invest in mutual funds without knowing exactly where the money is invested. Moreover the existence of financial companies or bonds would also render such mutual funds impermissible.

With respect to giving *zakat* on mutual funds, one will have to analyze the balance sheet of each company one has a stake in, and determine the value of the following assets and liabilities in the company:

1. Cash
2. + Receivables
3. + Inventory (market value)
4. − Trade payables
5. − Current portion of long-term debt

Net *zakaatable* assets

Thereafter the value of the net *zakaatable* assets has to be converted to a per share figure and the *zakat* has be given on the number of shares one owns:

$$\frac{\text{Net } zakaatable \text{ assets}}{\text{Total \# of shares outstanding}} \times \text{\# shares owned by person} \times 2.5\%$$

The above is a very general and broad overview of the sample calculation. For more details please refer to scholars or our website, www.arij.ca.

One has to try his best to determine the companies in a mutual fund. However the best option for Muslims is to contribute towards self-directed RRSPs where one can individually choose *halaal* companies to invest in.

One has to try his best to determine which companies are in the fund and the composition of their balance sheets. Otherwise *zakat* may need to be given on the entire market value of the portfolio. Please refer to scholars for specific scenarios.

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Zakat self-assessment form

Cash (at home, in the bank, or kept in trust with someone).	$
Market value of gold and silver (whether or not in the form of jewellery and whether or not the jewellery is being used).	$
Merchandise, inventory, raw materials and manufactured goods for the purpose of resale.	$
Market value of bonds, treasury bills, and shares/stocks bought for resale and capital gains.	$
Money in future income plans: RRSP, RESP etc.	$
Value of Zakat-able assets in corporations in which one owns shares, where the shares were purchased with the intention of earning dividends.	$
Debt owed to oneself (people owing you money).	$
Rent due from others.	$
Total Zakat-able assets	***$***
Less/Deduct: Liabilities	
Money you owe to people.	$
Amounts payable for the purchase of goods.	$
Unpaid bills and rent.	$
Bank loan.	$
Unpaid tax liability.	$
Unpaid wages due to employees.	$
Wife's dowry if one has in intention to pay.	$
Total liabilities	***$***
Net Zakat-able assets:	
(Total Zakat-able assets - Total liabilities)	$
If Net Zakat-able assets is less than *nisab* then there is no Zakah	-
If Net Zakat-able assets is equal to or more than *nisab* then Zakah is 2.5% of net Zakat-able assets	$
Total Zakah:	***$***