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# TOWARDS ALTERNATIVE APPROACH ON *ZAKAT* INVESTMENT ON PENSION FUNDS

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Abstract

*Pension is a system in which the employer contributes savings for the employee after his retirements, through this system a very big amount of assets are saved and invested, either by the employee or the employer, pension helps a lot of retirees to attain a sustainable life after their work age. Pension system is a new concept in the Islamic economics timeline, but Muslim scholar accepts it as permissible transactions, if it is saved or invested in line with shariah principles. Recently, scholars have shown concern over the zakatabilty of funds allocated in pension savings, to help Muslims employers observe their religious obligation. Zakat is a compulsory alms ordained by Allah on every Muslim who owns wealth or property that meets the conditions of zakatabilty, the conditions includes; the ratio of amount in which zakat is paid called (nisab), the passage of year (al-haul), right of ownership, and free from debts. It is clear that an employee could meet these conditions under some pension plans. This study discusses the classifications of pension plans with a view to find pension plans suitable Islamic economic principles, and suggests the appropriate ways of investing pension funds using Islamic investment portfolios. Finally the paper recommends the establishment of Islamic pension managers where it's not available and strengthening them to cover all financial*

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*services offered by the conventional pension managers and investors. Doing this will help Muslims achieved the joy of their pension funds without falling under the temptations of illegality.*

**Introduction**

During of the Prophet, *zakat*able items were very familiar since the sources of wealth were well known. *Zakat* is levied on camels, sheep, cows, goats, gold, silver, agricultural products and trade goods (Qardawi 2006). A property exempted from *zakat* in the life of the Prophet includes properties for personal use such as living house, clothes and furniture.

In the early Muslim epochs, the *zakat* collection was carried by the state as a tax imposed by *shariah* and distributed among the needy (Marshal 1985). *Zakat* as an Islamic welfare system, was not only seen as a mere spiritual charity, but was enforced on the power and autonomy of the state so as to affirm the sustainability and the wellbeing of the community through redistributing wealth.

Lately, Muslim scholars have shown serious concern over the change in the concept of wealth as it differs drastically from the traditional concept. They have been debating on the possibility of *ijtihad* over the newly emerging *fiqhi* issues related to *zakat* collection and distribution (Mahmud and Shah 2008).

Other scholars concluded that inability of the *zakat* funds to serve as an effective fiscal tool against poverty is mainly due to the inefficient *zakat* collection and distribution (Chapra 1992). Among the major indications of fewer *zakat* funds observed by the scholars is the issue of narrowing interpretation the lifetime of the *zakat* and its principles. This leads to limiting the chances of application of *ijtihad* to enhance the methods of *zakat*. This study aims to examine the *shariah* provisions over the investament and *zakat*abilty of pension funds. to achieve this, this study gives a brief introduction to *zakat* and the criteria for *zakat*abilty of wealth, with emphasis on the *nisab* (*zakat* ratio), *al-haul* (passage of a year), full right of ownership, and free from debts. This gives way to understand that pension funds are *zakat*able whenever these conditions are achieved then *zakat* is imposed. The study also examines the concepts and classification of pension funds with a view to find pension plans suitable Islamic economic principles, and suggests the appropriate ways of investing pension funds using Islamic investment portfolios. Finally the paper recommends the establishment of Islamic pension managers where it's not available and strengthening them to cover all financial services offered by the conventional pension managers and investors. Doing this will help Muslims achieved

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the joy of their pension funds without falling under the temptations of illegality.

**The Criteria for *Zakat*ability**

Early jurists had looked at the application of *zakat* from the traditional sources and had identified *zakat* as a duty imposed on all properties that are likely to grow or bring profit to the owner. They concluded that only the natural growing assets could be subjected to *zakat* (Tabrizi 741 H). Growth and profitability are further explained as; something that provides profit or benefits the owner; something that grows surplus; newly acquired item like business for profitability; or the livestock reproduction.

(Al- Kasani 1986) maintained, "The meaning of *zakat* is growth and growth in general does not exist except there is a growing wealth. We do not mean that the wealth automatically grows, but we mean is that such wealth is prone to grow by any means, such as grazing, trading etc. Grazing becomes the source of milk, reproduction and meat, while trading is the root of profits".

It must be observed that this view may have negative effects on *zakat* collection in the corporate sector. This is due to the cause that *zakat* will only be charged on the circulating wealth, and not the fixed assets of the company.

Al-Shaukani (1250 H) maintained that *zakat* is legislated to help the poor and relieve them from poverty without impoverishing the rich. And clearly this is done by taking from their surplus. Therefore, if *zakat* is imposed on the wealth that does not grow, it is irrational, since *zakat* is paid annually in addition to the living expenses.

It is clear, that the classical scholars were of the view that; assets meant for personal use, assets that do not grow are not subjected to the obligation of *zakat*; and only growing, and profitable assets are drawn to the category of *Zakat*able.

The implications of this view could be portrayed as following:

Items subjected to *zakat* are:

i. The key wealth types known at the time including; livestock, inventory of trade, gold and silver
ii. Part of income concomitant to the major kinds of wealth or income, saved in form of wealth, regardless of its sources
iii. Agricultural products

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iv. Natural resources

Items exempted from *zakat* include:

i. Human skills and resources
ii. Income used for consumption
iii. Items meant for personal and family use such as houses, horses, furniture etc.

Petty things not meant to be trade inventories such as laborers' tools.

**The *Nisab* (Rate)** (Sheriff, 2014)

Classical jurists considered the traditional sources of *zakat* to be the *Quran* and *Sunnah*. They agree that there is no *zakat* imposed on any property, unless it reaches the *nisab*, laid by *shariah*. The limit of *nisab* was institutionalized by the Prophet S.A.W. The Prophet determined *nisab* for *zakat*ability as follows: five camels and above; forty sheep and beyond 200, 2.5 for silver *dirhams* and five *wasq* (653 kilograms) for grain.

Khan (1995) further relates that whenever above properties reach the *nisab*, the following four types of rates are imposed:

i. 2.5% from the business capital
ii. 10% or 5% from the farm produce
iii. According to the detailed codes of livestock
iv. 20% of the found treasures

Abu Saud (1988) quoted Ibn Taymiyah's support for the rationale behind the differences in the rate. He believed that the effort required for diverse wealth types differ according to their nature, and as a result, the *nisab* must vary.

**The Condition of *Alhaul* (Passage of a year)**

Majority of the scholars agree that a complete lunar year has to pass over a *zakat*able possession after its ownership. This condition is only applicable to the capital assets, such as money, business stock and livestock.

Arguments arose concerning the time allocated for determining the passage of a year. *Shafi'iyyah* and *Hanabilah* for instance, maintained that the *nisab* must be constant throughout the year. While *Hanafiyyah* believed that the *nisab* is only required to be present at the end and the beginning of the year. Similarly (Qardawi 2006) believes that

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*zakat*able properties such as crops, fruits, minerals, found treasure, salaries and wages are all classified as earned income (*mal al-mustafad*). This kind of income according to his view does not require the passage of year to determine its *zakat*abilty.

**Full Right of Ownership and Free from Debts**

Another condition considered by the early Muslim jurists is that, before assessing the *nisab* of *zakat* for a property, the owner must enjoy the privilege of a full right of ownership. The property must be free from all kinds of debts or liabilities. They further divided the *zakat*able wealth into two categories; wealth that can clearly appear (*zahir*); and wealth that does not clearly appear (*batin*). *Zahir* is a kind of property that can be seen by the poor and assessed by the *zakat* collectors, for instance, livestock and crops. In contrast, *batin* is a property that needs a testimony of the owner before its proper assessment.

*Hanafiyyah* jurists maintained that the first category would be free from *zakat* if overwhelmed by debt. They justify this argument by stressing that *zakat* is a right of the poor taken from the rich. And in such case, the right of the debtor holds a higher priority than the right of the poor. Thus, the debtor should be settled first. On the contrary, *Shafi'iyyah* jurists stayed firm on their stand that *zakat* being an act of worship, is a right of Allah, and that this right supersedes of any other rights (Qardawi 2006).

Nevertheless, with a stern hold, *Hanifiyyah, Shafi'iyyah* and majority of the scholars agreed that for the non-apparent wealth, it would be free from *zakat* if the owners were indebted. However, in a situation where the remaining balance reaches the *nisab*, the *zakat* must be deducted from the remaining wealth.

Nevertheless, with the aid of latest advancements in the field accounting and finance, discussion on the matters of wealth related to the aspects of *zahir* and *batin* is no more relevant. Nowadays, all assets could be assessed using a simple formula as a means of calculation.

**Pension System**

Pension is a system that aims at providing the employee a safety net of financial resources after retirement from service. It may be guaranteed as cash flow in monthly basis or a lump sum amount paid normally after the employee leaves work and has no salary income. Organisations have different ways of handling pension funds depending on the adopted systems, while other serves as custodians of the pension funds and hand it

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to the retiree after the end of his service; others employ the services of established brokerage houses as self-directed plans driven by the tax incentives. Payments to these houses are made in a certain times it may be monthly, quarterly or annually according to the designed periods (Rahman, 2014).

In recent days, pension service receives a wide variety of systems and plans, driven by the nature of substances, contributions and benefits. However, all differences and variations of pension plans can be categorised into two major forms; this are generalised in whether the provision of the pension services gives the contributor the liberty to make prudent decisions regarding the stream of cash flows retirement life, or the pension manager is responsible to guarantee the methods of cash payment to the retiree based on some predetermined formulas. Other common variations in pension funds management emerged in terms of as to whether the retiree is responsible for investment and shares the risk and bears the cost of portfolio management associated with his invested funds. Or the manager handles the investment and takes the profit and the risk. It's also carries in terms of if the retiree is at livery to transfer his pension account from the previous employer to a new employer.

This results in major classifications of pension plans to defined-benefit plan and defined-Contribution plan.

**Defined-benefit plan**

Defined-benefit plan is a situation when the employer or the plan sponsor is committed by the pension contract to provide certain amount of cash flow periodically or cash lump amount to the employee upon his retirement. Under this plan, payment to the retiree are predetermined and stayed in the statutory formula based on agreed conditions such as; length of service, age at retirement date, salary history, highest salary received and salary at the retirement date. An example of this plan is demonstrated by Texas Pension Plan for higher education and K-12 education employees in the state, they operate a system called Teacher Retirement System (TRS). In this system monthly pension payments is calculated according to the number of years of service, multiplied by 2.3 of the average highest five annual salaries divided by 12 (Texas Coordinating Board, 2013).

Under this plan it is the responsibility of the employer to provide money to pay for the benefit of the employee, the cash flow required to make benefit payments to the retiree are partially generated through reinvesting previous contributions from the employer and/or employee during the periods of his service. In a situation when the

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employer had already setup money to meet the contribution, the defined-benefit is referred to as funded defined-benefit plan. But when there are no funds made by the player to pay for the benefits upon retirement but pays the benefit at when the employee retires it is referred to as unfunded defined-benefit plan. The advantage of the second plan is that the employee is guaranteed his benefits without requiring him to make any investment decision that leads to loss in some instances.

According to McWhinney (2009) employers believes that defined-benefit plans are part of their liabilities and as such funding of such a liability must come from corporate earnings, which in turn results into direct impact on the profits.

**Defined-Contribution Plan**

This is a pension plan in which the employer is mandated to contribute an amount according to a certain agreed percentage of the current salary of the employee, the contribution may be made monthly, quarterly or annually. In most plans, the employee is also required to pay some certain amount of contribution from his received salary, the contributions are then invested in markets and the employee is allowed any form of available investments alternatively. An example of these methods is demonstrated by Oregun University Systems (OUS) USA. The system adopted is that the university agrees to pay 16.5 per cent of the employees current salary, the employee is also required to contribute 6.0 per cent to make the total contribution 22.5 per cent of his total income (Oregun University System, 2000).

Many financial investors provide services on behalf of employees the proceeds of these services are reaped by the employees after their retirements. Under this kind of plan, the employer contributions towards the retirement of the employees are "defined" but the total benefits are not determined, unlike the previously discussed defined-benefit plan where the retirement benefits are pre-determined. In this method income generated through the employee, the contribution of the employer and the potential profit/loss on the invested funds are accumulated together in the account of the employee, thus making the total pension earning difficult to be determined. Here the employees are responsible for the business risk and are at liberty to make choice of investment interests and could transfer their pension accounts to another employer.

**Defined-Benefit and Defined-Contribution Plans: The Islamic Perspective**

In order to compare the two plans from the Islamic points of view we need to stress that the common differences between the plans includes issues related to age at retirement

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time, current and on-going salary, potential years of service, previous retirement benefits (if any), and current and anticipated financial positions.

However, from sharia perspectives, the most glaring differences between the two plans which the ability to make decisions on the types of investment portfolio to embark upon by the investors assets, the employees willingness to accept the risk and share the loss of the investment of their choices.

It is crystal clear that defined benefit plans favours the long term employees over the short term employees, it may also benefit employees that start to work at older age than those working at younger age. On the other hand, defined-contribution plan favours the younger generation of employees and employees who have records of participating in similar plans with previous employers. This is manifested in the flexibility of the defined-contributed plan that allows transfer of benefits to a new employer.

Despite observed differences and categorisation of pension plans, all plans are important and beneficial to the employees in many ways; saving prepared to be active and support the employee when he leaves work and probably got weak to scout for earnings, it provided opportunity to invest and save without taxes, and pays taxes at lower rate after retirement.

Islamically, its evident clear that the defined-benefit plans cannot be treated differently for the purpose of *zakat* calculation on the basis of year-to-year retirement account balance; this is in line with the Islamic concept of justice and equity in distribution of wealth. And therefore the *shariah* provisions supports defined-contribution plan over the diff med benefit plan, especially when the employer is allowed to choose either of the two plans.

Defined-contribution plan is preferred due to its flexibility that gives the employee a choice mandate to select investment assets with the help of professional managers. Here a conscious Muslim employee may prefer to invest in sharia compliant portfolio and securities that employs using *shariah* screening guidelines used by global *shariah* indices, or *shariah* screening guidelines provided by the Accounting and Auditing organisation of Islamic financial institutions (AAOIFI). Unlike the situation if defined-benefit plan is adopted where the employer or the pension manager is at liberty to invest at portfolios of his wish. Normally under defined-benefit plans the managers prefers to invest in more conservative and conventional strategy like interest bearing investments, fixed income bonds or other aggressive strategies of investment, these kinds of investments are full of uncertainty and closure and totally not in conformity with *shariah* provisions (Rahman,

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2014).

***Zakat* on Pension Funds**

Retirement benefit or pension funds are new concepts added in the fields of Islamic economics, the traditional Islamic economic systems do not make provisions for any plan after work. But considering that it's a mandatory policy accepted universally as conditions of service, Muslim scholars deemed it fit to finds it a legal backing under the concept of Islamic legal maxims provisions that says "all transactions are permissible except when it contradicts the provisions of *Shariah*". From the definitions of Retirement benefit above it is clear that it does not contradict the provisions of *shariah* by origin, but it is needed to be governed by *shariah* principles.

Islamic scholars categorised pension funds into two classifications: mandatory pension plans and non-mandatory pension plans. Mandatory pension plans are those plans sponsored by the employer or the employee under conditions of compulsory participation by both parties; the funds are deducted monthly from the salary source as part of the employments contracts to be included in the pension benefit package of the employee. The specifications of jobs under mandatory plans made it impossible for any employee to abort.

While non-mandatory plans are pension systems that offers an optional system to in opposite to mandatory plans, this systems allows the employee the liberty to choose whether to participate in the plan or not. Although, this plans attracts more taxes many employees prefers to participate with this plan due to its flexibility, such as the employee is at liberty to decide the amount to be paid after meeting his basic needs, which results in giving him opportunity to have more surplus and freedom of early withdrawal. However, stipulated charges are made on early withdrawal.

From the *shariah* perspectives, Muslim jurists maintained different opinions with regards to *zakat* on alternative pension plans, Qardawi (1999) states

> *"A question which commonly arises these days concerns retirement savings and pension contributions that are retained by governments, employers, or other independent agencies to which the contributor has no direct access, except upon retirement or termination of employment. The zakat on such funds is determined by whether they can be defined as being completely owned by the contributor. Can he dispose of them at will or not? Are these funds the right of the contributor or mere contributions whose value will be determined at the time of retirement? If*

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> *they are purely contributions or gifts, they accrue only to the contributor at the time of receipt. But if they are part of what the contributor has access to and may dispose of at will, then they should be treated like debts owed by people who are capable and ready to pay, i.e. they are subject to zakat every year, once they reach the nisab for zakat."*

In supporting this view, Qardawi refer to Imam Maliks views regarding *zakat* and debts where he the former insists that *zakat* should not be paid on debts until it's received back. And therefore concluded that *zakat* is not due on retirement benefits until the year it's received. Imam Hanifa in another hand as supported by Muhammad Ibn Hassan and Imam Abu Yusuf maintained that payment of *zakat* on debts is not at the immediate receipt of debts; rather it must past a year under the custody of the owner (Rehmani 1983).

However, scholars like Usman and Qazi (2010), Kahf (2002) supported Qardawi's view as more consistent to *shariah* provisions. They maintained that when the assets are kept with the employer of pension manager, the ownership still belongs to the employee but due to the fact that he cannot manage or control the property, he is freed from *zakat* payments, but whenever it's received *zakat* must be paid as it has reached all conditions of *zakat*ability.

Usman and Qazi (2010) quoted mufti yaqi Usmani as said

> *"If the salary of the employee is deducted at source, without giving this amount to the employee, zakat is not payable on the amount kept in the retirement account, until the employee receives the same. When an employee receives it on his retirement, the amount so received shall form part of his zakatable assets of that year only, and such part of it, that is not spent before the valuation date, shall be subject to zakat, and zakat will be payable on the aggregate balance of his assets (including the balance of the amount received from the fund) on the valuation date."*

But when the plans applied by the pension managers falls as non-mandatory scholars agreed that *zakat* is pains annually if the assets have reached the *zakat* rario (nisab). Scholars treated non-mandatory plans as personal investments that the investor is at liberty to deposit and withdraw at his own time. This is becomes the employer received the benefit cash from his employer and deposit it with the pension managers as savings or investments. This kind of plans are in conformity with what Qardawi (1999) classified as funds which the employees have privilege to access and dispose at will. Although there

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are stipulated penalties and charges for early withdrawal, the conditions of free access to the funds makes its ownership complete and therefore *zakat*able. These kinds of funds are similar to loans that are expected to be paid without any fear or loss.

Usman and Qazi (2010) further quoted Mufti Taqi Usmani as said "*If the employee first receives the amount and then with his own intention, puts the money in the retirement account, then this money will become the subject matter of zakat and zakat will be obligatory for all the years in which the money is kept in the fund*."

*Zakat* on non-mandatory plans are giving the same treatments attached to *zakat* on invested properties Muslim jurists had unanimously agree that *zakat* is imposed on invested properties in stocks and bonds. They only differ on the methods of *zakat* applications on such funds.

Scholars like Abu Zahrah and Abdulrahman Hassan and Abdulwahab Khallaf treated invested funds in stocks and bonds as business merchandise (urudu-al-tijarah) and maintained that all tradable shares and properties most be subject to *zakat* if they meet the conditions for *zakat*ability. They further insist that to calculate *zakat* on such assets the value of such properties in the markets must be recognised to determine the nisab of 2.5 percent (Islahi &Ubaidullah 2004).

The later opinion is accepted by the Organisation of Islamic Countries (OIC) in its fourth session held in Jeddah, Saudi Arabia on February 6-11 1998. The resolution derails as follows:

> *"If the shareholder has invested in shares for trading purposes, then his shares are subject to zakat as commercial goods. After the lapse of one year period, and if they are still in his possession, he shall pay zakat on their market value. He will pay 2.5 percent of their market value plus their dividends." (Islamic Development Bank, 2000).*

Similarly, Muslim scholars have agreed on inclusion of dividends and interest income into the *zakat* folds. However, there are differences of opinions regarding additional money or property to the investment during the year, is it to be calculated altogether at the end of the initial properties time or is to be given another times in accordance with condition of passage of year.

Qardawi (1999) summarised the scholastic arguments on this issue in the following

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> *"The third case is if the acquired asset is the same kind as already-owned assets that have reached nisab, and have started the zakat year, but acquiring the new assets is independent of the already owned assets. For example, someone owns forty sheep and during the year he purchases or is given as a gift another twenty. Zakat is not due on those sheep in that year according to Ahmad and ash-Shafi'i'. Abu Hanifa says it should be added to what he already owns and zakat is due on the total at the end of the zakat year, except in the case when this new asset is obtained merely in exchange for an older one that zakat has already been paid on. He adds that letting the acquired mal have a separate time for zakat would cause accounting and collection difficulties, all of which should be avoided in accordance with the ayat, ' . . He has not placed any constraint on you in the deen.' (Quran 22:78). Malik agrees with Abu Hanifa in the case of pastured livestock, while in money he tends to agree with Ahmad and ash-Shafi'i' because according to him, the above mentioned difficulty does not arise."*

Qardawi insists that Imam Malik's views could be more applicable and appropriate. Others scholars like Kahf recommends that any additional property within the *zakat* year should be treated the same with the initial properties as the opinion of hanafi school of thoughts. This opinion by Kahf is seen by this study as more consistent especially when the added amount is not up to nisab, then there will be gap in the assets of *zakat* from a *zakat* payer, which is inconsistent with the *zakat* traditions.

**Proposed Model for Pension Funds Investment**

Muslim pension funds suffered serious threats of being invested in aggressive and conventional investments by pension organisations that are purely profit oriented not Islamic ethics oriented. This situation is caused by the lack Islamic investments and financial services in a many countries, and the lack of Islamic pension managers even in some Muslim countries adopting the Islamic economic systems as options to conventional systems.

In Malaysia for instance, funds collected as Employees Provident Fund (EPF) are invested only in a number of approved financial investments in order to generate profits. These financial investments includes; Malaysian Government Securities, Money Market Investments, Loans and Bonds, Equity and Property. After meeting the required terms and conditions of pension services and EPF systems, both capitals and profits of these investments are returned to the employee after his retirement the following table

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illustrates the instruments in which EPF funds are invested.

**Table 1: EPF Investment Portfolio**

| | Strategic Asset Allocation (%) | Variation (%) |
|---|---|---|
| Malaysian Government Securities | 25 | 15 to 35 |
| Loans and Bonds | 25 | 15 to 35 |
| Money Market Instruments | 15 | 5 to 25 |
| Equities | 20 | 10 to 30 |
| Property | 5 | 0 to 10 |
| International Investments | 10 | 0 to 20 |

Source: Magda et al, (2011) Implementation of investment guidelines: the experience of the Employees Provident Fund.

Recently, Islamic financial investments received overwhelming interest of investors especially among the Muslim communities, this call for governments' intervention in many communities. This study takes Malaysia as an example on how to find alternative solutions to pension funds investment to meet the *shariah* provisions. This study prefers to create a dichotomy between the conventional pension investment and Islamic pension investment using the same portfolio investment pattern. The alternative Islamic portfolios are designed by Magda et al (2011) as follows:

**Table 2: The dual investment will be according to the following strategic asset allocation:**

| Type Investment | Market Space | Strategic Asset Allocation (%) | Variation (%) |
|---|---|---|---|
| Conventional | Malaysian Government Securities | - | - |
| **Islamic** | **Malaysian Government Islamic Securities** | - | - |
| Conventional | Loans and Bonds | - | - |
| **Islamic** | **Islamic Bonds / Sukuk** | - | - |
| Conventional | Money Market Instruments | - | - |
| **Islamic** | **Islamic Money Market Instruments** | - | - |
| Conventional | Equities | - | - |
| **Islamic** | **Shariah Stock** | - | - |
| Conventional | Property | - | - |
| **Islamic** | **Islamic Property** | - | - |
| Conventional | International Investments | - | - |
| **Islamic** | **International Islamic Investments** | - | - |

Source Magda et al (2011), Zakah from Salary and EPF: Issues and Challenges

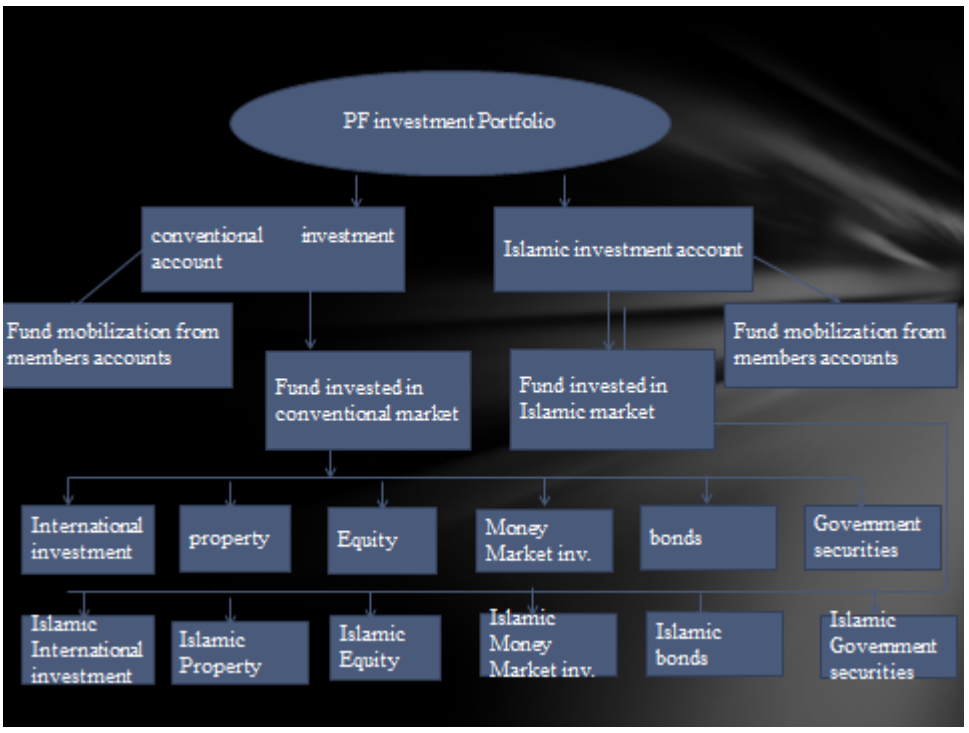
The study suggests the adoption of a new strategy in assets allocation that gives the

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employee a freedom of choosing Islamic compliant investment portfolios. The suggested investment portfolios are as follows:

- Government Islamic Securities
- Islamic Bonds/Sukuk
- Islamic Money Market Investments
- *Shariah* Stock
- Islamic Property Managements
- International Islamic Investments
- Islamic Structured Products

**Figure 1: Dichotomy of *Shariah* Investment Portfolios from Conventional Investment Portfolio of Pension Funds**



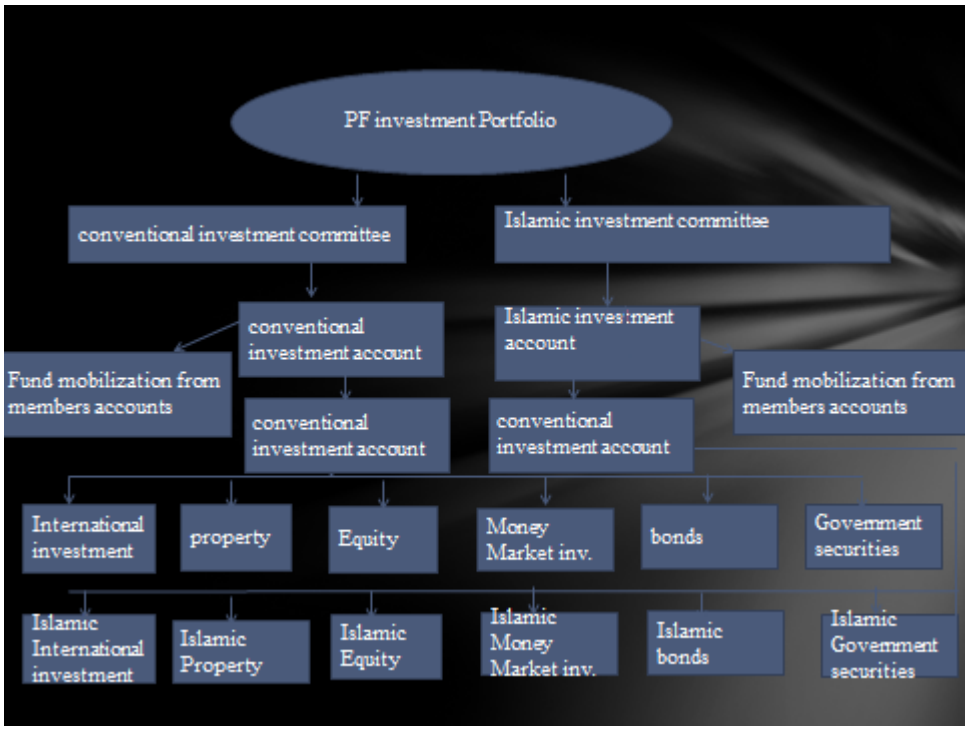

Investment portfolios in Islamic finance are not limited to any kind of halal (permissible) business transaction, but restricted to any form of interest bearing business or trading unlawful products in Islam or harmful objects. This provision helps in

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diversifying the potentials of inventions and creativity in Islamic financial services.

In order to ensure strict adherence to the Islamic provisions, this study suggests the establishment of *shariah* governing committees whose responsibility is to ensure *shariah* compliance by the Islamic pension managers and investors. *Shariah* committees are also responsible to provide guidelines on the investment portfolios that are accepted by *shariah* and offer technical advice on administration and governance of the entire institution. The following figure illustrates *shariah* governance framework in pension investments

**Figure 2: Pension Funds Investment Portfolio & *Shariah* Governance Framework**




**Empirical Practices of *Zakat* Payments on Pension Funds**

Recall, this paper had earlier examined the scholastic discussions on issues related to *zakat* payments on pension funds and finds that *zakat* payment on mandatory plan should be carried at the time of receipt of the pension funds, while payments on non-mandatory plans should be observed annually by the employees. Muslim communities in recent days constitutionalise *zakat* payments on salaries, pensions, wages, rents, profit and dividends

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and bonds. These constitutional provision varies according to different a states and communities. Malaysia and Kuwait for instance, *zakat* payment is constitutionalised but made it on voluntary payments (Sheriff 2015). While Sudan law made it compulsory for all Muslim residents in Sudan and Sudanese but resident in other countries to pay their *zakat* to the *zakat* organisation (Sheriff 2015 b). The law also empowers the *zakat* chamber of Sudan to deduct *zakat* from the salaries of staff from direct payer's sources. In Malaysia a tax rebate system is introduced as a form of encouragement for *zakat* payment. The following table illustrates how tax rebate is carried in Malaysia.

**Table3: Payment of Zakah through Tax Rebate in Malaysia**

| Monthly salary | Income tax payment | Zakah Payment | Tax-Rebate |
|---|---|---|---|
| | Considered 1 wife and 1 child | Considered 1 wife and 1 child | |
| 2,500 | Nil | 30.42 | -- |
| 3,000 | Nil | 41.92 | -- |
| 4,000 | 130 | 64.92 | 65.08 |
| 5,000 | 250 | 87.92 | 162.08 |
| 6,000 | 424 | 110.92 | 322.08 |
| 7,000 | 620 | 133.92 | 486.08 |
| 8,000 | 860 | 156.92 | 703.08 |
| 9,000 | 1100 | 179.92 | 920.08 |
| 10,000 | 1352 | 202.92 | 1149.08 |
| 11,000 | 1612 | 225.92 | 1386.08 |
| 12,000 | 1872 | 248.92 | 1623.08 |
| 13,000 | 2132 | 271.92 | 1860.08 |
| 14,000 | 2392 | 294.92 | 2097.08 |
| 15,000 | 2652 | 317.92 | 2334.08 |
| 16,000 | 2899 | 340.92 | 2558.08 |
| 17,000 | 3172 | 363.92 | 2808.08 |
| 18,000 | 3432 | 386.92 | 3045.08 |
| 19,000 | 3692 | 409.92 | 3282.08 |
| 20,000 | 3952 | 432.92 | 3519.08 |
| 21,000 | 5460 | 455.92 | 5004.08 |
| 22,000 | 5720 | 478.92 | 5241.08 |
| 23,000 | 5790 | 501.92 | 5288.08 |
| 24,000 | 5980 | 524.92 | 5455.08 |
| 25,000 | 6500 | 547.92 | 5952.08 |

Source: Source Magda et al (2011), Zakah from Salary and EPF: Issues and Challenge

Malaysian *zakat* system adopts a model that allows *zakat* payers to pay their *zakat* in instalment on monthly basis, the *zakat* managers considers the basic needs of the employees and his burden such as number of wives, children housing, feeding etc to determine if the remaining balance has reached the ration of *zakat* funds.

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## Conclusion and Recommendation

Although the economic world is difficult to understand by a large segment of the society, but *Shariah* rules are simple to understand and easy to adopt It is the duty of every Muslim to give time to his financial matters to check them under *Shariah* rules so that to save him from forbidden transactions and to pay the compulsory obligations.

To help a conscious Muslims observed their religious duties and avoid the divine wrath, this study suggests that employers at various levels; states or private corporate organisations should help adopts defined-contribution pension plan to meet the desire and faiths of Muslim employers. The study also suggests that the defined-benefit plans are categorised as non-mandatory plan in *shariah* perspectives, under this plans employers are at liberty to avoid theor funds being invested in portfolios that are not *shariah* oriented to avoid earning from unlawful. But the implication of this preferred plans are all assets and properties invested including the profits generated are subject to *zakat* once the meet the conditions of *zakat*abilty. *Zakat* on such investment could be made annually or by instalment.

The study suggests the dichotomy between the conventional investment otherwise known as unethical investment and Islamic financial services and investments, thus giving the Muslim investors to enjoy the same services and expect similar profits while avoiding the risk of involvement into unlawful transactions. It is also insisted that all transactions are lawful in Islam except that which contradicts the *shariah* provision, this provision paves way for new inventions in to the services of Islamic pension managers.

This study also recommends the establishment of *shariah* governing committees aiming at ensuring *shariah* compliance and offer technical advices on the kinds of investment and services to be offered by Islamic pension funds managers, and determine the *zakat*abilty and the *zakat* ration of the invested funds.

Finally the study recommends future study in this area especially in aspects of determining the acceptability, readiness or otherwise of Muslim retirees to invest with this organization and provide a framework for government and provoke implementation, and asses the potentials of Islamic pension investment houses at large.

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