

Zakah Practice in Islamic Banking Institution in Malaysia: A Legal Horizon

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ABSTRACT

The objective of the *zakah* payment is focused on the economic development of the *ummah* (society) and *baladah* (nation) and not only confined to the ritual practices. Islamic banking institutions (IBIs) in Malaysia are one of the entities that accountable for banking *zakah*. This paper will look in depth the concept and the legality of *zakah*. Besides, this paper also will deliberate the legal background of IBIs and analyze specifically on the *zakah* practice among the IBIs in Malaysia. This paper is totally a qualitative research paper in which it is more exploratory in nature and possibly resulting in the development of concepts and theories. Furthermore, historical approach will be used as to find out how and why certain rules, principles or institutions have come to take their present form. In addition, this paper also recapitulates all issues and challenges encountered by IBIs in Malaysia *vis a vis* *zakah* practice. Finally, some recommendations will be laid down such as the needs to propose a new statute to administer banking *zakah* and to set up a proper body to supervise on the aforesaid statute as well as to improve the *zakah* practice in IBIs in Malaysia.

Keywords: Banking Zakah, Zakah Practice, Islamic Banking Institution.

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1.0 INTRODUCTION

The Islamic transaction and finance are emerging rapidly in Malaysia. This growth has been prompted majorly by Islamic banking institutions (IBIs). The IBIs were established since the establishment of the first Islamic bank i.e. Bank Islam Malaysia Berhad. Conventional banks also triggered the expansion of Islamic transaction and finance previously after offering 'Islamic Window' (*Skim Perbankan Islam-SPI*). In present days, the latter conventional banks have diversified their banks and turn into full fledged Islamic banks. It indicates the mass development of IBIs in Malaysia and even being observed by other countries too.

However, it should be submitted that IBIs must abide by rules that stipulated in Islam *vis a vis* the obligation of *zakah* payment from its Islamic banking transactions and businesses. The *onus* is on IBIs so as to purify the profits generated from Islamic banking businesses as well as to assist the needy and community. Some scholars defined the *zakah* as part of Corporate Social Responsibility (CSR). Thus, this paper will look in depth the concept and practice of banking *zakah* in Malaysia.

2.0 THE CONCEPT AND THE LEGALITY OF ZAKAH

2.1 Definition of Zakah

Zakah is one of the five pillars of Islam. The word *zakah* is derived from the root *zaka* (زكى) which means to grow, to increase, clean and nice. When it is said about a person, it means to improve or to become better (Monzer Kahf, 2012). Consequently *zakah* is blessing, growth, cleanliness and betterment as mentioned in the divine word of Allah;

قد أفلح من زكها

Meaning: "Truly he who succeeds that purifies (with faith and good deeds)."

(Surah al-Shams: 9)

Based on *fiqh* perspective, there are various definitions given by Muslim jurists (Fuqaha') on *zakah* definition. Imam al-Nawawi defined *zakah* as a portion of a specific property which is commanded by Allah to be handed over to specific person with specific requirements. A specific portion of specific a property is called *zakah* because the property will be increased, becomes meaningful and

protects the wealth of a person from devastation (Muhammad Najib al-Muti'i, t.t).

According to Imam al-Syarbini, *zakah* is the name of a specific portion of a specific property, which must be issued or paid to a specific person with specific conditions (Muhammad al-Syarbini al-Khatib, 1958). Imam Shafi'i has stated *zakah* means a name to a specific property, specific portion and distributed to specific people (M. Iman Sastra Mihajat and Bedjo Santoso, 2010). While Imam Ibn Qudamah mentioned that the pronouncement of *zakah* is derived from *zaka* ' (زكاة) which means (نماء). The word *nama*' means to evolve, to increase and to produce. The property is called *zakah* for the lasting value and productives (Ibn Qudamah, 1972).

Based on the aforesaid definitions provided by *fuqaha'*, we can conclude that *zakah* is an essential right of a property in the eyes of *Shariah*. Eventually, it will be taken out from a specific portion of a specific property with specific rates after it satisfied with all requirements prescribed by *Shariah* to be distributed to legal recipients (*asnaf*) as laid down in *Shariah*. It is a legal burden upon all individuals. It has a direct impact not limited to relationship between man and Allah SWT as the Creator, but also within the relationship between man and society (Nur Qamarin Nur Qamarina Sharom et. al, 2011). The objective on the payment of *zakah* is not only concentrated on the ritual practice solely but *thereto* concentrated on economic and finance. It facilitates the distribution of property from not being monopolized by the rich and elite, but also to other needy groups, poor and not capable people.

2.2 Categories of Zakah

Zakah can be categorized into two main categories, namely *Zakah Fitr* and *Zakah Al Mal*. *Zakah Fitr* is a payment that is paid to those in need on or before the first day of Shawwal (after Ramadhan) (CIOGC, 2013). While *Zakah Al Mal* can be defined as a payment that is paid by individuals who have wealth amount at the same rate or in excess of the minimum amount (*Nisab*) for a whole year (*haul*) and to give to those in need (JAWHAR, 2010). This *Zakah Al Mal* can be classified into different classifications such as Income Zakah, Savings Zakah Gold and Silver Zakah, Crop Zakah, Trade Zakah, Banking Zakah and so forth. This paper will be discussing on *Zakah Al Mal* particularly the obligatory of Banking Zakah in Islamic banking institutions in Malaysia.

2.3 Compulsory Requirement For Banking Zakah

Each and every trade or business transaction from business asset owned by Muslims is obliged to pay *zakah* so as banking *zakah*. There are certain requirements that need to be satisfied and the requirements are as follows:

2.3.1 Islam

Zakah is an obligatory for Muslim. This requirement indicates that in a joint stock business between a Muslim and a Non-Muslim, the imposition of *zakah* will be borne on the portion owns by a Muslim. A Non-Muslim is not required to pay it because *zakah* is an act of approaching and showing obedience to Allah. It is clearly mentioned in the *hadith* narrated by Muadz in which Prophet Muhammad *Sallahu Alaibi Wassalam* said to him:

“...invite the people to testify that there is no deity but Allah and I am the Messenger of Allah.”

Then the prophet added after he had mentioned performing prayer:

“...If they obey you to do so, then tell them that Allah has made it obligatory for them to pay zakah from their property and it is to be taken from the wealthy among them and given to the poor.”

(Al Bukhari (1395) (3/330) and Muslim (121) (1/146)

From this *hadith*, it can be inferred that Islam is a pre-requisite for *zakah* payment. The obligation of *zakah* is upon a person who embraces Islam and not to non-believer.

2.3.2 Full Ownership

Full or legitimate ownership implies that a property has been acquired lawfully and the acquired person has full right to use or dispose of it, to sell or to *hibah* or to invest it in anyway as he intends. No *zakah* will be imposed upon a property whose ownership is not established.

2.3.3 Intention to Run Business

Banking *zakah* will be imposed to an asset that is intended for business purpose (to gain profits). If the asset that is not intended for business purpose and it is therefore not to be included in the *zakah* computation and assessment. Fixed assets used for business are not subjected to *zakah* but if the assets used for

rental purposes then the income of the fixed assets are subjected to *zakah* computation and assessment. This also will be applied to the income of sold fixed assets.

2.3.4 Full Lunar Year (Haul)

The possession of wealth for a period of one full year (Haul) is one of the most requirements for *zakah*. The wealth or profit gained from business must be operated for at least a year according to the *Qamariah Islamic* calendar which is estimated 354 days. The *Haul* period is counted from commencement date of business. This is based on the *hadith* of Aishah;

“No zakah is to be taken from a property until a year passes on it.”

(Recorded by Ibn Majah (1792) (2/373) and At Tirmidhzi (630,631) (3/25,26))

If there is any additional capital in the business, *haul* will be counted from the commencement date of business. For business property assessment, Imam Syafie opined that it must be assessed at the end *haul* of business (JAWHAR, 2010). *Zakah* assessment is based on the position of assets, liabilities and capital at the end of *haul* business, which is based on the Balance Sheet. The values contained in the Financial Statements at the end of the operations of a business are used for the *zakah* assessment purpose.

2.3.5 Zakah Threshold (Nisab)

Property or goods of business must attain *nisab* according to the current value of 20 *mithqal* gold (85 grams) (JAWHAR, 2010). 20 *mithqal* gold is equivalent to 5 *anaq* of silver (200 dirham for pure silver) and a herd of less than 5 camels (Farishta G. De Zayas, 2003). *Zakah* computation for trade is derived from the *hadith* narrated by Abdullah Ibn Umar, where Prophet Muhammad *Sallahu Alaibi Wassalam* said,

“No zakah is to be paid on (a herd of) less than 5 camels, nor on less than 40 sheeps and / or goats, nor or less than 30 oxen, nor or less than 20 mithqal of gold, nor or less than 200 dirham (silver), nor or less than 5 camel-loads (of agricultural produce). And 10% zakah (is to be paid on) dates, raisins, wheat and barley, and crops watered by natural means (i.e. rainfall or river etc) are subject to 10% and crops watered with well water are subject to zakah of 5 %.”

(Recorded by Al Bukhari)

Nisab is calculated from the excess of basic needs and free from any debt of an owner. However, Imam Shafie opined that no such conditions of debt in determining whether a property attains *nisab* or not. The debtor is obliged to pay *zakah* from the money he borrowed if the money in his full ownership tills the end of *haul* (JAWHAR, 2010).

In order to make *zakah* assessment, certain rules need to be abide by such as it must be a *halal* property, a productive property (*Al Nama'*), source of business property must be on the basis of sale or transfer, the business property must not being used for personal purpose and the property not being changed to cash that less than *nisab* at the end of *haul* (JAWHAR, 2010).

3.0 THE LEGAL BACKGROUND OF ISLAMIC BANKING INSTITUTION IN MALAYSIA

According to the Islamic Financial Services Act 2013 (IFSA), Islamic banking institution must be defined as part and parcel of Islamic financial institution by virtue of Section 143. The said section clearly mentions the Islamic financial institution refers to a licensed Islamic bank or a licensed international Islamic bank or an approved operator of a payment system or an operator of a designated payment system or an approved issuer of a designated Islamic payment instrument. A licensed Islamic bank means a person licensed under section 10 to carry on Islamic banking business and includes a licensed international Islamic bank (Section 2, IFSA).

By looking at section 10 of IFSA, Bank Negara Malaysia (Bank Negara) will make a recommendation to the Minister of Finance to grant a license to a respective bank which met all requirements needed by IFSA to carry on Islamic banking business, *takaful* business, international Islamic banking business or international *takaful* business, with or without conditions (Schedule 5 of IFSA). The licensed Islamic bank then will operate Islamic banking business which means the business of accepting Islamic deposits on current account, deposit account, savings account or other similar accounts, with or without the business of paying or collecting cheques drawn by or paid in by customers; or accepting money under an investment account; and provision of finance; and such other business as prescribed under section 2 of the aforesaid act.

On the other side of coin, the Central Bank of Malaysia Act 2009 (CBMA) defines Islamic financial institution as a financial institution carrying on Islamic financial business. By virtue of Section 2 of the act, Islamic financial business means any financial business in ringgit or other currency which is subject to the

laws enforced by the Bank Negara and consistent with the *Shariah*. However CBMA is silent on the definition ‘consistent with *Shariah*’. Thus, we have to cross refer to PART IV Division 1 of IFSA with reference to Section 29 (1) where it is clearly stated that:

The Bank may, in accordance with the advice or ruling of the Shariah Advisory Council, specify standards—

on Shariah matters in respect of the carrying on of business, affair or activity by an institution which requires the ascertainment of Islamic law by the Shariah Advisory Council; and to give effect to the advice or rulings of the Shariah Advisory Council.

It means that Islamic banking business must be in accordance with the teachings of Islam which shall not involve any transaction in gambling (*maysir*), interest (*riba*), alcoholic products and goods (*kebams*) and others. To determine whether all the Islamic businesses, activities and affairs in parallel with *Shariah*, Bank Negara will follow the advice or ruling of the Shariah Advisory Council (SAC). SAC is the highest authority body in Bank Negara and has *locus standi* to ascertain the Islamic law for the purposes of Islamic financial business (Section 52 of CBMA). The IBIs must appoint *Shariah* Committee (SC) and act on the advice of the SC as stipulated in Section 30 of IFSA. Normally, all rulings made by SAC will bind SC for each IBIs. If IBIs fail to do so or acted in a manner which is not in compliance with *Shariah* or the advice of its *Shariah* Committee, the IBIs shall cease in carrying business and operation as well as to surrender its license to Bank Negara (section 18, IFSA).

Therefore, it could be understood that *zakah* is part of *Shariah* matters in IBIs and in *pari materia* with IFSA and CBMA. Even IFSA and CBMA is silence on *zakah* in IBIs, the practice of *zakah* herein it’s payment is still under the supervision of SC. By referring to Section 30 of IFSA, the SC must advice an IBI on business, activity and affair that should be compliance to *Shariah*. Thus, *zakah* is part of activities in Islamic banking matters and under the purview of SC.

4.0 LEGAL RESEARCH METHODOLOGY

Research refers to the collection of information in a systematic manner on a range of topics (Paul Oilver, 2010). Generally, this research paper will be focusing on the legal research. Legal research is usually refers to any systemic study of legal rules, principles, concepts, theories, doctrines, decided cases, legal

institutions, legal problem, issues or questions or a combination or all of them (Anwarul Yaqin, 2007). This research paper aims to collect and analyze case law, journals together with any relevant legislation. This is often done from historical perspective. The historical approach involves an objective study of the past facts, events or institution (Mahdi Zahraa, 1998). In this research paper, the historical approach will be used as to study the development of law relating to *zakah* from divine approach until the modern approach. A research may involve either wholly or partly the study of legal problems in a comparative perspective. The purpose is to examine similarities and dissimilarities between two situations existing within the same legal system (Mahdi Zahraa, 1998). This method will be used in this research paper as to examine the differences in terms of principles, theories, concepts and its institutions within the ambit of *zakah*.

A sample is a portion or subset of a larger group called a population. The target population consists of the institutions, persons, problems and systems to which or whom a study's finding is to be applied or generalized (Arlene Fink, 2010). The sample is drawn on the assumption that it is a 'representative' of the population (Anwarul Yaqin, 2007). In verification of qualitative research particularly this research paper, the population and samples will be picked from Islamic banking institutions and *Zakah* institution.

The instrument of research that will be used in this research paper is interviews. Interview is a widely used method of information collection. It is a process of conversation in which the interviewer asks question with the purpose of obtaining information and respondents answers. Commonly, it will be used in order to gain the experiences, opinions, attitudes, feelings and perceptions (Anwarul Yaqin, 2007). This research paper used the semi structured interviews which were conducted through the sample from the varieties of related agencies of *zakah*.

Secondly, document analysis is a part of the methods in this research paper. It is an important research tool in its own right and is an invaluable part of most schemes of triangulation. Documentary work involves reading lots of written material. Most of the documents that will be analyzed are the official documents. These official documents will be taken from IBIs, State Zakah Institutions under State Islamic Religious Councils (SIRCs) as well as statutes. The documents will be compared and differentiated among documents as to find the possible solution to the problem arose.

5.0 ZAKAH PRACTICE IN ISLAMIC BANKING INSTITUTIONS

In general, *zakah* is an obligation to all qualified person. A qualified person could be a natural person or an artificial person (legal person). This paper will highlight on the banking *zakah* made by companies (IBIs) in which IBIs could be deemed as legal persons. IBIs normally paid their *zakah* on their voluntarily basis. If IBIs decline to pay *zakah*, no action or sanction will be imposed upon them. Based on an interview with the Head of Islamic Banking Division in one Islamic bank in Malaysia, he mentioned that not all IBIs pay the *zakah* payment to any *zakah* institution in Malaysia (Muhammad Hafiz Badarulzaman *et.al*, 2015). Each IBIs has their *zakah* computation and payment method. According to the data collected on 7th January 2015, there are IBIs which pay half of accumulated *zakah*, some of IBIs pay *zakah* more than accumulated *zakah*, some pay *zakah* according to state poverty rates and there are some pay *zakah* according to their most operated businesses of the state and so forth.

Based on the experience of one IBI under IFSA 2013, banking *zakah* will be paid by the shareholders and saving *zakah* will be paid by depositors. Half of the payment of *zakah* will be handed over to State Islamic Religious Councils (SIRCs) and the remaining of *zakah* portion will be distributed by IBIs themselves. Likewise the *zakah* practice under one of IBIs that governed by the Development Financial Institution Act 2002 (DAFIA), banking *zakah* will be borne solely by the shareholders and saving *zakah* by depositors. As per mentioned by Head of Islamic Banking Division of IBIs under DAFIA, *zakah* was paid more than the accumulated *zakah* amount to all SIRCs according to the size and population of respective state. This IBI gives full authority to SIRCs to distribute the accumulated *zakah* without taking any single cent back.

By referring to the experience of Jabatan Zakat Negeri Kedah (Zakat Kedah), Bank Islam Malaysia Berhad (Bank Islam) is the highest paying bank to pay *zakah* in Kedah (Muhammad Hafiz Badarulzaman *et.al*, 2015). Bank Islam has chosen Kedah because it has many branches and the highest operated businesses in that state. The payment of *zakah* in Kedah was made around March or April at the beginning of each year by IBIs. However, some IBIs delay to pay *zakah* (around two or three months) on the ground to find the exact time to invite their Chief Executive Officer (CEO) of IBIs to hand over their *zakah* payment to Zakat Kedah or to present their *zakah* payment to His Majesty, Sultan of Kedah.

The computation and the assessment methods of *zakah* are varies among IBIs. This is due to the resolutions or rulings made by their respective SC. Each SC of IBIs in Malaysia has their juristic views and thoughts that will bind IBIs. Some

IBIs compute *zakah* by using working capital method, growth capital method and profit capital method.

Most IBIs will refer to *zakah* manual issued by Jabatan Waqaf, *Zakah* and Haji, Malaysia (JAWHAR) as their Standard Operating Procedure (SOP) of *zakah*. The manual will serve as a guide and will not be implemented wholly. This is due to the fact that each IBIs has their manuals and guidelines. However, this research paper could not analyze and discuss pertaining to IBIs' manuals because of that manuals are confidential and could be disclosed to public as well as researchers. An officer in *Zakah* Kedah pointed out that the manual drafted by JAWHAR needs to be updated so that it will be in line with current *zakah* practices by IBIs (Muhammad Hafiz Badarulzaman *et.al*, 2015). Some IBIs mentioned that manual drafted by JAWHAR is not binding upon them. Interestingly, there is one IBI which did not follow the manual and did not pay at all *zakah* due to their just cause.

6.0 ISSUES AND CHALLENGES OF ZAKAH PRACTICE IN ISLAMIC BANKING INSTITUTIONS IN MALAYSIA

AAOIFI is an acronym for Accounting and Auditing Organization for Islamic Financial Institution provides a set of guidelines known as the FRS 1 of the Financial Reporting Standard No. 1. AAOIFI is a set of accounting law in the Islamic banking and financial institutions that have signed and agreed upon and signed by all Islamic banking and financial institutions in 1990 in Algeria. However AAOIFI was registered and confirmed in Bahrain in 1991 as an autonomous international corporation that does not generate profits.

According to AAOIFI FRS 1, all Islamic banking and financial institutions should reflect their responsibility to pay *zakah* in the financial statement on behalf of shareholders and investors. In Malaysia, MASB-1 (No. 1 Malaysian Islamic Accounting Board) does not provide a clear emphasis on *zakah* in Islamic banking and financial institutions. For MASB-1, *zakah* is only a liability and a special burden in the statement of accounts and is not an Islamic obligation (Nur Barizah Abu Bakar and Abdul Rahim Abdul Rahman, 2008). If the collection of *zakah* is an obligation, then the question will be posted is whether there is any existing provision of law or statute that requires the collection of *zakah* in IBIs in Malaysia?

As far as the IBIs are concerned, these institutions are corporate bodies (companies) and legal persons. It can be looked into the judgment given in the case of *Salomon v Salomon* [1897] AC 22 whereby the court was held that a

company which has been lawfully incorporated becomes a separate legal entity or personality (i.e. it is recognized as an artificial person) from its directors/shareholders. Therefore, any liability incurred by the company is limited to the company and to recover any debt, the creditors have to sue the company and not its directors/shareholders since liability does not extend to them but is limited to the company. This distinction is important for both the directors of the company and those entering into contracts with the company. In Malaysia, this concept is based on the provision laid down under Section 16(5) of Companies Act 1965.

Based on that ground, the question will be raised again on whether IBIs can pay *zakah* for all banking transactions even there are specific provisions in company law and the effect of separate legal entity. The legal entity in banks is separated from members and shareholders (Aishah Bidin, 2006). If the obligation is on the burden of shareholders or members, the bank will have no responsibility. The bank also cannot impose the obligation upon the members and shareholders to pay *zakah* since the effect of separate legal entity.

Furthermore, *zakah* is a religious affairs and it is certainly under the jurisdiction of the state through the Ninth Schedule (Fed List) and Second Schedule (State List). All aspects pertaining to the administration of *zakah* are under the jurisdiction of the states through the SIRC. There are a total of fourteen SIRC, one for each of the thirteen states and one for the federal territory. Due to the demand of more efficient and effective collection and distribution of *zakah* funds in Malaysia, some of the SIRC have corporatized the institution that responsible on collection (and distribution) of *zakah* in those respective states Nur Qamarin Nur Qamarina Binti Sharom, et al, 2011). Eight SIRC have so far corporatized, starting with Pusat Pungutan *Zakah* (PPZ), Wilayah Persekutuan in 1991, followed by Pusat *Zakah* Selangor, Pahang and Pulau Pinang in 1995, and lastly Pusat Pungutan *Zakah* Negeri Sembilan and Melaka in 2000. It was followed by Tabung Baitulmal Sarawak in 2001 and the latest was Pusat *Zakah* Sabah that has been corporatized in 2007. However, up till today, only Selangor, Pulau Pinang, Sarawak and Sabah are fully corporatized (both collection and distribution affairs) (Norazlina Abd. Wahab and Abdul Rahim Abdul Rahman, 2011).

In the light of that, we have to note that IBIs are under the purview of Bank Negara. It can be viewed through Section 2 of CBMA 2009 whereby every banking business, Islamic banking business as well as other financial institutions must be licensed by Bank Negara. Thus, the power to license as well as power to monitor the operation of banking business is on the shoulder of Bank Negara. If the collection of banking *zakah* done by IBIs, it would amount to conflict of

interest between SIRC and Bank Negara. Moreover, Malaysia adopted two branches of law namely Islamic law and common law. Both laws have their own courts whereby the cases dealt with Islamic law will be heard by *Shariah* court and the cases dealt with common law will be decided by civil court. However since banking *zakah* in IBIs is comprised of Islamic and civil principles, the issue now is whether *Shariah* court has jurisdiction upon banking *zakah* in IBIs or *vice versa*? Ultimately, the civil court has *locus standi* to hear Islamic Banking cases since the banking business could be defined as commerce or business as laid down in Section 3 and Section 5 of Civil Law Act 1956. It also should be submitted that there is none of federal law with regards to *zakah* collection in IBIs. Thus, it portrays certain *lacunae* and hiccups in this issue. Besides, there is none of piece of law mentioning on power conferred to the enforcement body to take legal action upon IBIs in the case of failure to pay *zakah*. These are among the issues and challenges encountered by IBIs in present days.

7.0 RECOMMENDATIONS AND CONCLUSION

In a nutshell, this paper had highlighted various issues and challenges in banking *zakah* faced by Zakah Institutions and IBIs. The payment of banking *zakah* could accommodate needs of the *zakah* legal recipients. It would also give thousand of benefits and betterments of the ummah. The imposition of banking *zakah* upon each IBIs is totally based on the concept of '*Adalah* and *Maqasid Shariah*.

As indicated by the paper, there is a need to draft a single statute pertaining to banking *zakah* of IBIs. The aforesaid piece of legislation should be effective as soon as possible and there is a need to set up a central body to enforce the proposed statute. The enforcement body should be centralized in order to uniform the law. Furthermore, the *zakah* administration and management in IBIs in terms of collection and distribution must be carried out professionally and diligently. The method of computation must be accurate and the distribution should be reached to the proper legal recipients.

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