

## SUSTAINABILITY OF BUSINESSES VIA SHARIAH-COMPLIANT FRAMEWORK: ANALYSIS OF SHARIAH PRINCIPLES ON CORPORATION

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### ABSTRACT

Corporation under common law lies within the doctrine of corporate personality which entails that corporation is recognised as a separate legal person distinct from its constituents. As a new form of business vehicle that supports sustainability agenda and with the recent enormous and instant developments in the Shariah compliance businesses sector, the majority of contemporary Muslim scholars have discussed and recognised it through the concept of *sharikah*. Nonetheless, such recognition is contentious as *sharikah* is a contractual business entity inseparable from its partners. Furthermore, accepting this corporation under the *sharikah* without fully dissecting its legal attributes and the implications of running such a business entity not only contravenes both the legal principles of corporation and Islamic principles of *sharikah*, but also creates doubt as to the legitimacy of a Shariah-compliant business registered under this legal concept. This article analyses the legal concept of corporation under the common law and compares it with the concept of *sharikah* under Shariah. The discussion reveals that the recognition of corporation by the contemporary Muslim scholars under the *sharikah* concept is misleading and raised legal complications under the company law due to great differences in terms of nature, concept, and structures. This article adopts doctrinal and comparative analysis research methodology. The article concludes that corporation may be recognised under the Shariah subject with certain modifications to the

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former's legal structures to be compatible with the Islamic principles of *sharikah*.

Keywords: Corporation, Separate Legal Entity, *Sharikah*, Shariah.

## **KELESTARIAN PERNIAGAAN MELALUI KERANGKA SYARIKAT: ANALISIS PRINSIP-PRINSIP SYARIAH TERHADAP SYARIKAT**

### **ABSTRAK**

Syarikat di bawah undang-undang sivil adalah di bawah doktrin personaliti korporat. Doktrin ini menjelaskan bahawa syarikat diiktiraf sebagai satu badan korporat undang-undang yang berasingan daripada ahli-ahlinya. Sebagai satu bentuk entiti perniagaan baharu yang menyokong agenda kelestarian dan dengan perkembangan pesat dalam sektor perniagaan patuh Syariah mutakhir ini, majoriti para ulama Islam kontemporari telah membincangkan dan mengiktirafnya melalui konsep *syarikah*. Walau bagaimanapun, pengiktirafan kepada konsep tersebut adalah dipertikaikan kerana *syarikah* adalah entiti perniagaan berasaskan kontrak yang tidak dapat dipisahkan daripada ahli rakan kongsinya. Tambahan pula, penerimaan syarikat tersebut di bawah konsep *syarikah* tanpa meneliti sepenuhnya sifat-sifat perundangannya dan implikasi daripada menjalankan entiti perniagaan tersebut bukan sahaja menyebabkan percanggahan di antara prinsip undang-undang syarikat dan prinsip Islam *syarikah*, malah ia juga menimbulkan keraguan terhadap kesahihan perniagaan patuh Syariah yang berdaftar di bawah konsep ini. Artikel ini menganalisis konsep perundangan syarikat di bawah undang-undang sivil dan membandingkannya dengan konsep *syarikah* di bawah Syariah. Hasil perbincangan mendedahkan bahawa pengiktirafan syarikat oleh ulama Islam kontemporari di bawah konsep *syarikah* adalah mengelirukan dan menimbulkan komplikasi undang-undang di bawah undang-undang sivil syarikat disebabkan perbezaan ketara daripada aspek sifat, konsep, dan struktur masing-masing. Artikel ini mengaplikasikan metodologi penyelidikan analisis doktrin dan perbandingan. Artikel ini membuat kesimpulan bahawa syarikat boleh diiktiraf di bawah undang-undang Syariah tertakluk kepada pengubahsuaian tertentu kepada struktur perundangan syarikat tersebut agar selari dengan prinsip-prinsip Islam *syarikah*.

**Kata kunci:** Syarikat, Entiti Perundangan Berasingan, *Syarikah*, Syariah.

## INTRODUCTION

Modern corporation (company) is a recent business organisation phenomenon.<sup>1</sup> Its chief significance hegemonises the world in various sectors and has been positioned in many branches of law such as company law, competition law, securities law, tax law and others. The company is also viewed as a business entity model that operates businesses benefitting social and environmental impacts, inspired by Goal 10 (Reduced Inequalities) of the Sustainable Development Goals (SDGs). In Malaysia, a corporation is established under the legal statute, the Companies Act 2016 (CA 2016). Embodied from the common law, a corporation is a body corporate and a separate artificial legal person distinct from its members and directors. With the existence of this modern business vehicle and the rapid trend of Shariah-compliant business sector worldwide nowadays, the majority of contemporary Muslim scholars have discussed and recognised this corporation under the Shariah by referring to the concept of *sharikah* (Islamic partnership) in a seeming similarity.<sup>2</sup>

Nonetheless, such reference to the latter's concept is untenable as *sharikah* is a contractual business entity inseparable from its partners. Furthermore, accepting this corporation under the *sharikah* concept without fully scrutinising its legal attributes and the implications of employing such a business entity contravenes the legal principles of corporation and the Islamic principles of *sharikah*, respectively. This leads to questioning the legitimacy of a Shariah-compliant business registered under this legal concept.

Previous studies have been conducted by several academic writers such as Abd Ghadas and Abdul Aziz<sup>3</sup>, Nyazee<sup>4</sup> and the like,

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<sup>1</sup> Carsten Gerner Beuerle and Michael Anderson Schillig, *Comparative Company Law* (Oxford University Press, 2019), 3.

<sup>2</sup> Mas Nooraini Mohiddin, Zuhairah Ariff Abdul Ghadas, and Nazri Ramli, "Developing Shariah Compliant Corporation: An Appraisal on The Rights and Liabilities of Members under The Malaysia Law and Shariah," *Journal of Nusantara Studies* 6, no. 1 (2021): 66–67, <https://doi.org/http://dx.doi.org/10.24200/jonus.vol6iss1pp59-72>.

<sup>3</sup> Zuhairah Ariff Abd Ghadas and Hartinie Abd Aziz, "Legal Framework of Corporation and Shirkah Al-Inan : A Comparison," *International Journal of Law and Interdisciplinary Legal Studies*, (2018): 19–27, 26.

<sup>4</sup> Imran Ahsan Khan Nyazee, *Islamic Law of Business Organization: Corporations* (India: Adam Publishers & Distributors, 2010), 114–117.

have shown the peculiarities between both entities that need more addressing from the Shariah perspectives. Nonetheless, their studies are confined to a direct comparison between corporation and *sharikah al'inan* only. In addition, they do not evaluate other views conveyed by other contemporary Muslim scholars of the same, particularly those who have recently criticised this matter again.

Therefore, this article aims to compare the legal concept of corporation under the common law with the concept of *sharikah* under the Shariah that is argued by contemporary scholars in recognising the former and to analyse to the extent the corporation can be recognised under the Shariah unconditionally or with modification to the former's legal structures to be compatible with the Islamic principles of *sharikah*.

## THE POSITION OF A CORPORATION UNDER COMMON LAW AND MALAYSIA LAW

Under the common law, a corporation is governed by the doctrine of corporate personality.<sup>5</sup> The doctrine fundamentally articulates that the corporation is regarded as a legal (juristic) person despite its nature as a non-human entity.<sup>6</sup> In other words, the concept of a legal person that had long been established as being other than a natural person is legally entrenched.<sup>7</sup> The artificial nature of a corporation is indeed ignored to the extent that upon incorporation under the legal statute, a registered corporation is a body corporate, a separate legal entity that possesses rights and owes duties like a natural person.<sup>8</sup> As a result, the law

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<sup>5</sup> Halyani Hassan, Zuhairah Ariff Abd Ghadas, and Nasarudin Abdul Rahman, 'The Myth of Corporate Personality': A Comparative Legal Analysis of the Doctrine of Corporate Personality of Malaysian and Islamic Laws," *Australian Journal of Basic and Applied Sciences* 6, no. 11 (2012): 191–192.

<sup>6</sup> Zuhairah Ariff Abd Ghadas, Nasarudin Abdul Rahman and Halyani Hassan, "Shari'ah Corporation': The Legal Entity of Corporation from the Malaysian Law and Shari'ah Perspective," *International Journal of Liability and Scientific Enquiry* 6, no. 4 (2013): 234.

<sup>7</sup> Elvia Arcelia Quintana Adriano, "The Natural Person, Legal Entity or Juridical Person and Juridical Personality," *Penn State Journal of Law & International Affairs* 4, no. 1 (2015): 366.

<sup>8</sup> Stephen Griffin, *Company Law Fundamental Principles*, 4th edn (Pearson Longman, 2006), 1.

recognises two kinds of persons, natural persons and legal persons, which typically refers to a corporation.<sup>9</sup>

The above doctrine is affirmed in the precedent case of *Salomon v. A Salomon & Co. Ltd* [1897] AC 22. The House of Lords held that the company created by Mr. Salomon is a separate legal entity distinct from its members, including him. Hence, he is not liable for the company's debts pursued by the unsecured creditors though he factually controlled it. This precedent introduced the bedrock legal principle of corporation that recognises the separateness of corporation as a legal person from its members as two distinct entities.<sup>10</sup> In fact, this case shifted and replaced the idea of corporation as an association of individuals (regulated by partnership principles) with the entity concept, which separates entirely both the corporation and its members. Such a concept has not ever been challenged by the judges since then.<sup>11</sup>

Under the CA 2016, the doctrine of corporate personality is well governed in Section 20(a) and (b), which state that:

“a company incorporated under this Act is a body corporate and shall have legal personality separate from that of its members and continue in existence until it is removed from the register.”

Furthermore, the legal principle in the *Salomon* case is firmly applied in *Sunrise Sdn Bhd v First Profile (M) Sdn Bhd* [1996] 3 MLJ 533 where Chong Siew Fai CJ of the Federal Court held that:

“We are in complete agreement with the basic principle of the fundamental attribute of corporate personality, i.e., that the corporation is a legal entity distinct from its members, be they individuals or corporate bodies, a principle firmly established since *Aron Salomon v Salomon & Co Ltd* [1897] AC 22.”<sup>12</sup>

In *Common Ground TTDI Sdn Bhd v Ken TTDI Sdn Bhd and Anor* [2021] 1 LNS 1709 (unreported), Mohd Nazlan J held that the

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<sup>9</sup> Zuhairah Arif Abd Ghadas and Hartinie Abd Aziz, “Legal Framework of Shari’ah Corporations in Malaysia: Special Reference to Waqf Corporation,” *Journal of Modern Accounting and Auditing* 13, no. 3 (2017): 121–122, <https://doi.org/10.17265/1548-6583/2017.03.004>.

<sup>10</sup> Ben Pettet, *Company Law, The Law Teacher*, 2<sup>nd</sup> edn, vol. 17 (Pearson Longman, 2005), 23, <https://doi.org/10.1080/03069400.1983.9992603>.

<sup>11</sup> Beuerle and Schillig, *Comparative Company Law*, 32.

<sup>12</sup> [1996] 3 MLJ 533, 543.

concept of separate legal entities is central to the corpus of company law.<sup>13</sup>

In addition, Murali asserts that corporation is also assigned with other legal attributes, such as the ability to continue its existence until removed from the register, the right to sue and to be sued, the right to own assets, property under its own name, owing its own liabilities, right to enter into a transaction with other parties and others.<sup>14</sup> These legal attributes are also regulated in the CA 2016.

### **Ability to continue its existence until removed from the register (perpetual succession)**

The perpetual succession of a company is envisaged under Section 20(b), as highlighted above. It means that the company persists to survive under the law while maintaining its personality despite changes in its shareholding membership.<sup>15</sup> Lim Chong Fong J in *Zamri Bin Arshad & 20 Others v. Misc Integrated Logistics Sdn Bhd [2018] 1 LNS 1103* (unreported) held that the change in shareholding of the company has no effect on its business.

### **Having full capacity to sue and to be sued**

A corporation can take legal action against any party for a wrong committed against it.<sup>16</sup> Section 21(1)(a) of the CA 2016 states that a company shall have the capacity to sue and to be sued. The court in *Foss v Harbottle (1843) 2 Hare 461* held that a company as a separate legal entity is the right party to enforce its rights or to sue the wrongdoers because it is the one who suffered from such wrongdoing, not its individual shareholders.<sup>17</sup>

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<sup>13</sup> [2021] 1 LNS 1709 (unreported), 17.

<sup>14</sup> Keerthan M Murali and Arya R, “A Study on The Concept of Juristic Personality,” *International Journal of Pure and Applied Mathematics* 120, no. 5 (2018): 99.

<sup>15</sup> Hassan, Ghadas, and Rahman, “‘The Myth of Corporate Personality’: A Comparative Legal Analysis of the Doctrine of Corporate Personality of Malaysian and Islamic Laws.” 193.

<sup>16</sup> Chan Wai Meng, *Essential Company Law in Malaysia, Navigating The Companies Act 2016* (Malaysia: Thomson Reuters, 2017), 64.

<sup>17</sup> Meng. 65.

### **Having full capacity to own assets and property under its own name and enter transactions with contracting parties**

Section 21(1)(b) of the CA 2016 conveys that a company shall have the capacity to dispose of any property, such as land, money, goods, goodwill, and any valuable things, as well as obligations. This legal attribute results in the legal and equitable ownership of the assets being confined to the corporation itself. Its members have no proprietary interest in them at all, thus no ownership rights.<sup>18</sup> In *Public Bank Bhd v. New Age Digital Print Sdn Bhd & Anor* [2019] 5 CLJ 1, the appellant appealed to the Federal Court on, among others, the issue of a claim made by the first respondent (company) and the second respondent (wife) against the appellant for wrongful payment of the sum of money from the joint current account through a forged cheque drawn by the company's managing director. The said joint account was opened by the wife's late husband as the company's controlling shareholder and managing director. The appellant contended that it had no contractual relationship with both respondents relating to the joint account and that they had no cause of action over the joint account to which the respondents were not parties. Rohana Yusuf FCJ allowed the appeal and held that both respondents had no cause of action over such joint account. If the claim was for the benefit of the company, it did not become part of the late husband's estate as claimed by the wife. By separate legal personality principle, the late husband had no legal or equitable right to the company's assets to be inherited by his wife although he owned all shares in the company.

### **Bearer of its own liabilities separated from its members**

This legal feature entails that a company incurs debts or liabilities separate from its members.<sup>19</sup> In other words, the corporation's debts are not those of its members; hence they are not liable for it.<sup>20</sup> This principle also forms a 'corporate veil' between the two which limits the

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<sup>18</sup> Paddy Ireland, "Company Law and the Myth of Shareholder Ownership," *The Modern Law Review* 62, no. 1 (1999): 45.

<sup>19</sup> John Lowry and Arad Reisberg, *Pettet's Company Law: Company Law & Corporate Finance*, 4th edn (Pearson Longman, 2012), 41.

<sup>20</sup> Meng, *Essential Company Law in Malaysia, Navigating The Companies Act 2016*, 63.

liability of its members.<sup>21</sup> This feature has a strong connection with limited liability which is provided in Section 192(1) that ‘a member shall not be liable for an obligation of a company by reason of only being a member of the company’.

## THE CONCEPT OF *SHARIKAH* UNDER SHARIAH

### Definitions of *sharikah*

According to Saleem, *sharikah* literally means ‘mingling of two properties in a manner that they could not be distinguished from each other’. Technically, it is ‘a contract between two or more partners in the capital and profit’.<sup>22</sup>

The definitions of *sharikah* according to classical Muslim scholars of four *madhhabs* (Islamic schools of thought) vary. The Hanafis define it as ‘a contract between two parties in relation to capital and profit’.<sup>23</sup> The Malikis define *sharikah* as ‘a permission by one partner to another to conduct *tasarruf* (transact) with partnership property and retain his right to transact with the said property as well’.<sup>24</sup> The Shafi’es define it as ‘the confirmation of the rights of two persons or more over a common property’.<sup>25</sup> Lastly, the Hanbalis define *sharikah* as ‘*istihqaq* (the amalgamation) of rights and/or freedom to transact’.<sup>26</sup> Abd Ghadas and Engku Ali list three essential elements of a valid *sharikah* from these definitions. Firstly, *sharikah* is essentially a contract between -at least- two or more individual partners. Secondly, it authorises the partners to transact with the capital

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<sup>21</sup> Aiman Nariman Mohd Sulaiman and Effendy Othman, *Malaysia Company Law: Principles and Practices*, 3<sup>rd</sup> edn (Malaysia: Wolters Kluwer, 2021), 62.

<sup>22</sup> Muhammad Yusuf Saleem, *Islamic Commercial Law* (John Wiley & Sons Singapore, 2013), 97.

<sup>23</sup> Muhammad Abd Al-Rahman Sadique, *Essentials of Musharakah and Mudarabah: Islamic Texts on Theory of Partnership* (Kuala Lumpur: IIUM Press, 2009), 5.

<sup>24</sup> Sadique, 5-6.

<sup>25</sup> Sadique, 6.

<sup>26</sup> Sadique, 7.



or partnership property. Thirdly, there exists the element of profit sharing among the partners.<sup>27</sup>

### Authority of *sharikah*

There are several Islamic authorities that support the permissibility of *sharikah*. Firstly, Allah says in the Qur'ān:

“...And certainly many partners wrong each other, except those who believe and do good—but how few are they...”<sup>28</sup>

The word “partners” (*khulata'* in Arabic term) mentioned in this verse connotes a partnership in property.<sup>29</sup> Next, in a Hadith Qudsi, it is stated that Allah (swt) says:

“I make a third with two partners as long as one of them does not cheat the other, but when he cheats him, I depart from them”.<sup>30</sup>

Ali Haidar explained that this hadith shows the permissibility of *sharikah*. He also asserted that in terms of logical reasoning, *sharikah* is a way to gain sustenance between two parties who do *sharikah* and gain benefit from one who provides the capital and his co-partner who conducts the business.<sup>31</sup>

### Types of *sharikah*

*Sharikah* is divided into two categories: *sharikah al-milk* (co-ownership) and *sharikah al-'aqd* (contractual partnership). Briefly, *sharikah al-milk* refers to co-ownership by a number of persons of an *'ayn* (ascertained property) or debt arising through inheritance, sale or

<sup>27</sup> Zuhairah Ariff Abd Ghadas and Engku Rabiah Adawiyah Engku Ali, “The Development of Partnership Based Structure In Comparison To the Concept of Musharakah (Sharikah) with Special Reference to Malaysia,” *Journal of Islam in Asia* 8(2) (2012): 307.

<sup>28</sup> Qur'ān, Surah al-Saad, 38:24.

<sup>29</sup> I'la' Al-Din Al-Za'tari, *Mawsua'h Fiqh Al-Mua'malat Al-Maliyyah Al-Muqoron* (Damascus, Syria: Dar Al-Usoma', 2012), 466.

<sup>30</sup> Abu Dawud Al-Sijistani, “Sunan Abi Dawud, Kitab Al-Buyu', hadith 3833, accessed 26 April 2023, <https://sunnah.com/abudawud:3833>.

<sup>31</sup> Ali Haidar, *Durar Al-Hukkam Sharh Majallah Al-Ahkam* (Dar Al-'Alim Al-Kutub, 2003), 5.

other means or though *khalt* (mixing).<sup>32</sup> The word '*khalt*' here refers to the joint and exclusive ownership of two or more persons resulting from *khalt* of their property in a manner that does not accept distinction or separation.<sup>33</sup> *Sharikah al-`aqd* refers to a contract between two or more partners in capital and profit.<sup>34</sup> Despite the differences between *sharikah al-milk* and *sharikah al-aqd*, Nyazee asserts that classical scholars do not dispute the fact that co-ownership is a consequence of *sharikah al-aqd*.<sup>35</sup>

*Sharikah al-`aqd* consists of three main types, which are *sharikah al-amwal* (a partnership of capital), *sharikah al-abdan* (a partnership of services) and *sharikah al-wujud* (a partnership of reputation or creditworthiness). For *sharikah al-amwal*, classical Muslim scholars further categorise it into two kinds; *sharikah al`inan* (limited partnership) and *sharikah al-mufawadhah* (equal partnership). The former refers to 'a partnership in which two or more partners contribute different amounts of capital and share the profit and loss in different proportions'. Meanwhile, the latter connotes 'a partnership in which two or more persons become partners in a venture on the condition that they equally contribute to the capital and management and equally share profits or losses'.<sup>36</sup>

Another form of *sharikah*, according to several classical Muslim scholars, is *mudharabah*. It refers to a partnership of profit between a *rabbul mal* and a *mudharib*. The former is a capital provider who provides capital to the latter, while the latter is also an entrepreneur who runs the business using such capital on his behalf. *Mudharabah* is unique as only *rabbul mal* who invests his capital into the *mudharabah* business while *mudharib* is the one who only manages it.<sup>37</sup>

<sup>32</sup> Imran Ahsan Khan Nyazee, *Islamic Law of Business Organization: Partnerships* (Malaysia: The Other Press, 2006), 17.

<sup>33</sup> Haidar, *Durar Al-Hukkam Sharh Majallah Al-Ahkam*, 15.

<sup>34</sup> Saleem, *Islamic Commercial Law*, 97.

<sup>35</sup> Nyazee, *Islamic Law of Business Organization: Corporations*, 38.

<sup>36</sup> Saleem, *Islamic Commercial Law*, 98.

<sup>37</sup> Mohiddin, Abdul Ghadas, and Ramli, "Developing Shariah Compliant Corporation: An Appraisal on The Rights and Liabilities of Members under The Malaysia Law and Shariah." 65.

### Fundamental rules and principles relating to *sharikah*

Regarding *sharikah al-`inan*, there are several rules and conditions that must be observed under Shariah. First, the partners must exist and have the capacity to enter into a contract, and the capital or subject matter of *sharikah* must be present. Second, the partners have the capacity to transact on their behalf under the principle of *wakalah* (agency). On this basis, they have the right to participate in the business affairs of *sharikah*. Third, all the partners must share profits.<sup>38</sup> The principle of profit and loss sharing in *sharikah* is in line with the *athar* (narration) of Sayyidina `Ali (Allah blessing be upon him), the companion of the Prophet Muhammad (peace be upon him), who says:

“Profit is upon their agreement and losses are distributed in accord to their capital contribution”.<sup>39</sup>

Additionally, contemporary scholars also discuss the principle of *sharikah* under Shariah. For instance, Ramadhan contends that a valid *sharikah* under the Shariah is built upon its compliance with Shariah principles or Islamic legal maxims, which are, among others, as follows:

- i. *Al-ghunm bi al-ghurm* (One is entitled to a gain if one agrees to bear the responsibility for the loss)

Ramadhan articulated that this maxim has a relation with the principle that ‘*sharikah* is built upon the concept of *`adalah* (justice) among the partners’. While receiving profits (based on their agreement), they must also bear the losses according to their capital contribution. As such, Islam forbids kinds of *sharikah* that contradict this principle.<sup>40</sup> Al-Baqmi contends that all the scholars agree that losses are borne in accordance with their capital ratio, and any condition imposed by one partner to another that he incurs liabilities less or more than his capital ratio is impermissible under the Shariah. Otherwise, such a condition

<sup>38</sup> Al-Za’tari, *Mawsua’h Fiqh Al-Mua’malat Al-Maliyyah Al-Muqoron*, 471-472.

<sup>39</sup> Muhammad Ahmad Kalib, *Al-Khorasoh Mafhumuha Wa Ma’ayiru Ihtisabiha Wa Tadbiquha Fi Al-Fiqh Al-Islami* (Dar Al-Nafais, 2010).

<sup>40</sup> A’thiyyah Abdullah A’thiyyah Ramadhan, *Mawsua’h Al-Qawai’d Al-Fiqhiyyah Al-Munazdamah Li Al-Mua’malat Al-Maliyyah Al-Islamiyyah Wa Dawruha Fi Tawjih Al-Nudzm Al-Mua’sirah* (Dar Al-Iman, Iskandariyah, 2007), 461.

is *fasid* (voidable) according to Hanafi and Hanbali scholars. This is opposed to Shafi'e and Maliki scholars, who considered it as *batil* (void).<sup>41</sup>

ii. Partnerships are based on agency and trust

Ramadhan clarified that all types of *sharikah* are based on *wakalah* and *Amanah*, that each partner who provides the capital delegates the authority to the other partner to transact on his behalf. Among the rulings arising from this maxim is that the partner's act of *tasarruf* is like a wakil in terms of the nature and limitations of such *tasarruf* that binds each other based on their co-ownership in their capital.<sup>42</sup>

iii. All transactions prohibited under Shariah on a single partner constitute a prohibition towards the entity of partnership. All prohibited transactions apply to the entity or body of partnership and an individual partner alike. Ramadhan argued that this principle affects the separate legal entity principle, as *sharikah* is based on *wakalah* among its partners. Since the *tasarruf* of each of the partners is considered a collective *tasarruf*, they share rights and liabilities arising from the *sharikah*.<sup>43</sup>

### **SHARIKAH AL-MUSAHAMAH (JOINT-STOCK COMPANY) AS A MODERN FORM OF SHARIKAH UNDER SHARIAH**

According to Ahmed, corporate law is a contemporary issue lacking in traditional *fiqh* (Islamic jurisprudence) literature.<sup>44</sup> Despite such contention, contemporary Muslim scholars have different views on the permissibility of *sharikah al-musahamah* under the Shariah though

<sup>41</sup>Salih Zabin Al-Marzuqi Al-Baqmi, *Sharikat Al-Musahamah Fi Al-Nidzam Al-Saudi Dirasat Muqabalah Bi Al-Fiqh Al-Islami*, 1st edn (Obeikan, 2019), 149-150.

<sup>42</sup>A'thiyyah Ramadhan, *Mawsua'h Al-Qawai'd Al-Fiqhiyyah Al-Munazdamah Li Al-Mua'malat Al-Maliyyah Al-Islamiyyah Wa Dawruha Fi Tawjih Al-Nudzm Al-Mua'sirah*, 474-476.

<sup>43</sup>A'thiyyah Ramadhan. 489-490.

<sup>44</sup>Habib Ahmed, "Islamic Law, Investors' Rights and Corporate Finance," *Journal of Corporate Law Studies* 12(2) (2012): 384, <https://doi.org/10.5235/jcls.12.2.367>.

recognising its peculiarity to the classical *sharikah* in terms of its nature and legal features.<sup>45</sup>

### ***Sharikah al-musahamah* in arab laws**

Al-Zuhaili clarified that the definition of a company in the companies laws of Arab countries is derived from the Ottoman Mejelle, which is similar to the definition of *sharikah* under Shariah.<sup>46</sup> Basically, a corporation in the companies laws of the Arab countries is divided into *sharikah al-ashkhas* (association of individuals) and *sharikah al-amwal* (association of capital), by which the *sharikah al-musahamah* falls under the second category.<sup>47</sup> Al-Zahrani depicts that *sharikah al-musahamah*<sup>48</sup>, in the Saudi Companies Law, resembles the current legal corporation under the common law by sharing several legal attributes such as legal personality and limited liability.<sup>49</sup>

### **Opinions of contemporary Muslim scholars on *sharikah al-musahamah* from a shariah perspective**

Contemporary Muslim scholars discussed the ruling of *sharikah al-musahamah* and its related matters from a Shariah perspective as follows:

#### ***i. Permissibility of sharikah al-musahamah as a form of sharikah***

The scholars differed this issue into two groups. First, 'Isa Abduh, Taqi Al-Din Al-Nabhani and others opposed it because its structures

<sup>45</sup> Muhammad Barak Al-Fawzan, *Al-Ahkam Al-'Ammah Li Al-Sharikah Dirasat Muqaranah Thibqan Li Nidzam Al-Sharikah Al-Saudi 'Am 1437 Hijri*, 2nd edn. (Maktabah Al Qanun wa Al-Iqtisad, 2018), 16.

<sup>46</sup> Wahbah Al-Zuhaili, *Al-'Uqud Al-Musammah Fi Qanun Al-Mu'amalat Al-Madaniyah Al-Imarati Wa Al-Qanun Al-Madani Al-Urduni* (Damascus, Syria: Dar Al-Fikr, 2014), 171.

<sup>47</sup> Wahbah Al-Zuhaili, *Al-Mua'malat Al-Maliyyah Al-Mua'sirah* (Damascus, Syria: Dar Al-Fikr, 2002), 129.

<sup>48</sup> In the preceding of this article, the term *sharikah al-musahamah* or corporation will be used interchangeably to connote the same meaning.

<sup>49</sup> Youseif Al-Qassam. M. Al-Zahrani, "Rights of Shareholders under Saudi Company Law 1965" (Brunei University, 2013), 66, 73.

contradict the *sharikah* principles.<sup>50</sup> Their main arguments are that it is not an agreement between two or more parties which requires *'sighah* (offer and acceptance), like the classical *sharikah*. In addition, unlike the traditional *sharikah*, *sharikah al-musahamah* represents both *al-shakhsiyyah al-'itibariyyah* and the fund. The corporate entity will do transactions with others, not the shareholders since they have no right to be involved in the former. In addition, the board is the agent of the entity (the fund), not the shareholders.<sup>51</sup>

Second, the majority group, such as Al-Khafif, Al-Zuhaili, Al-Khayyat and others, accept *sharikah al-musahamah* under the purview of *sharikah al-'inan* or *mudharabah* and directly apply all these principles into the former. They argued that *sharikah al-musahamah* is permissible like *sharikah al-'inan*, which is contracted upon the consent of the parties. In fact, the board of directors manage the affairs of *sharikah al-musahamah* on behalf of the shareholders.<sup>52</sup> In addition, Al-Khafif argued that it takes the ruling of *mudharabah*, where the shareholders provide the capital, and the company represented by the board will manage it.<sup>53</sup>

Nevertheless, several contemporary scholars have significantly identified the differences between *sharikah al-musahamah* and *sharikah* upon scrutiny of the former's structures. For example, El-Gari stressed that a corporation is fundamentally different from *sharikah* in terms of definition in that the former is a separate legal entity distinct from its members, while the latter is an association between individuals in terms of capital and work. In addition, a corporation does not entail the element of *ishtirak* (participation/sharing) between individuals. Assuming this element of sharing exists, it is not, however, a requirement for the valid formulation of a corporation. The introduction of separation of ownership and control in the corporation

<sup>50</sup> Abdul Aziz Al-Khayyat, *Al-Sharikat Fi Al-Shariah Al-Islamiyyah Wa Al-Qanun Al-Wadi'e*, 4th edn (Riyadh, Saudi Arabia: Muassasah Al-Risalah, 1994), 161-162.

<sup>51</sup> Ahmad Muhammad Al-Khalil, *Al-Ashum Wa Al-Sanadat Wa Ahkamuha Fi Al-Fiqh Al-Islami*, 1st edn (Jeddah, Saudi Arabia: Dar Ibn Al-Jawzi, 2002), 129-133.

<sup>52</sup> Al-Khalil, 111-123.

<sup>53</sup> A'li Al-Khafif, *Al-Sharikat Fi Al-Fiqh Al-Islami: Buhuth Muqaranah* (Dar Al-Fikr Al-Arabi, 2009), 123-124.

also dilutes the agency relationship between the board of directors and the shareholders, as assumed by many contemporary scholars.<sup>54</sup>

**ii. The concept of *al-dhimmah* for *al-shakhsiyyah al-`itibariyyah* (artificial personality) of *sharikah al-musahamah***

The majority of contemporary scholars recognised the concept of *al-shakhsiyyah al-`itibariyyah* akin to other Islamic traditional institutions such as *waqf* (endowment), *masjid* (mosque), *bait al-mal* (public treasury) and others by having their distinct rights and liabilities.<sup>55</sup>

In addition, they also discussed this concept under the *fiqh* principle of *al-dhimmah* (*dhimmah*). Literally, *dhimmah* means a guarantee or accountability. In technical terms, it signifies anything with attributes of human beings that denotes its *huquq* (rights) and *iltizamat* (responsibilities). In fact, *dhimmah* is related to the term *ahliyyah* (legal capacity), which demonstrates an entity having rights and bearing responsibilities or obligations.<sup>56</sup> While it is clear that classical Muslim scholars strictly confined *dhimmah* to human beings, the question arises as to whether such a concept could be extended to non-human beings like a corporation as a legal person.<sup>57</sup> Many contemporary scholars such as Uthmani, Al-Zarqa' and others argue that such a concept could be extensively applied to the corporation.<sup>58</sup> According to Al-Zarqa', *dhimmah* is rather an assumed thing and a

<sup>54</sup> Muhammad Ali El-Gari, "Al-Takyif Al-Fiqhi Li Ashum Sharikat Al-Musahamah," in *6th Shura Fiqh Conference 2015* (Kuwait, 2015), 197, <http://shura.com.kw/conferenceDesc.asp?pageID=21&confID=27>.

<sup>55</sup> Luqman Abdullah, Muhammad Ikhlas Rosele, and Wan Marhaini Wan Ahmad, "The Concept of Legal Entity from the Islamic Law Perspectives," *Pertanika Journal of Social Sciences and Humanities* 28(4) (2020): 3215-3217, <https://doi.org/10.47836/PJSSH.28.4.39>.

<sup>56</sup> Zainal A Zuryati, Mohamed Yusoff, and Ahmad N Azrae, "Separate Legal Entity under Syariah Law and Its Application on Islamic Banking in Malaysia: A Note," *International Journal of Banking and Finance* 6, no. 2 (2008): 145.

<sup>57</sup> A'li Mahyuddin Ali Al-Qarahdaghi, *Mabda' Al-Redha Fi Al-Uqud, Dirasat Muqoronah Fi Al-Fiqh Al-Islami*, 2<sup>nd</sup> edn (Vol 1, Beirut, Lebanon, Dar Al-Bashair Al-Islamiyyah, 2002), 353.

<sup>58</sup> Hassan, Ghadas, and Rahman, "The Myth of Corporate Personality': A Comparative Legal Analysis of the Doctrine of Corporate Personality of Malaysian and Islamic Laws." 194-195.

container of rights and obligations which is itself artificial under the Shariah.<sup>59</sup>

On the contrary, several scholars are of the view that the application of *dhimmah* to *sharikah al-musahamah* must be restricted. For instance, Nyazee observed that many contemporary scholars recognise the applicability of *dhimmah* to a corporation in an absolute manner without any reservations. For this reason, he contended that religious duties such as zakat, waqf etc., should not be imputed to the corporation as *dhimmah* is exclusively confined to natural human beings.<sup>60</sup> This is supported by Saleh's view that the Shariah differs from secular law in that it never envisages *dhimmah* bestowed to a non-human being as a device intended to provide a shield against liability or as a 'corporate veil' meant to protect members from liability.<sup>61</sup>

Basyuni argues that Shariah does not make the corporation *al-shakhsiyyah al-'itibariyyah* distinct from its partners' *dhimmah* (liabilities). Certainly, the Shariah recognises its personality in a certain limit that it represents the partners in managing the activities and aims to avoid their internal disputes (by having such legal personality). They, in fact, have the actual *dhimmah* to which are attached rights and liabilities.<sup>62</sup> In this regard, Ghadas and Abdul Aziz asserted that *sharikah* as a business entity is not separated from its partners since all of them are eventually the same entity.<sup>63</sup>

### ***iii. Limited liability as the legal feature of sharikah al-musahamah***

The feature of limited liability is also discussed by contemporary scholars. For example, Al-Zuhaili asserted that this concept is equivalent to the principle of *mudharabah* whereby the *rabbul mal* is

<sup>59</sup> Mustafa Ahmad Al-Zarqa', *Al-Madkhal Ila Nadzariyyah Al-Iltizam Al-A'mah Fi Al-Fiqh Al-Islami*, 1<sup>st</sup> edn (Damascus, Syria: Dar Al-Qalam, 1999), 198-199.

<sup>60</sup> Nyazee, *Islamic Law of Business Organization: Corporations*, 107.

<sup>61</sup> Nabil Saleh, "Arab International Corporations: The Impact of the Shari'a," *Arab Law Quarterly* 8, no. 3 (1993), 181.

<sup>62</sup> Abd Al-Awwal 'Abidin Muhammad Basyuni, *Mabda' Hurriyyat Tadawul Al-Ashum Fi Sharikat Al-Musahamah* (Dar Al-Fikr Al-Jamii'e, 2008), 14.

<sup>63</sup> Ghadas and Abd Aziz, "Legal Framework of Corporation and Shirkah Al-Inan : A Comparison", 26.



not liable for any debts incurred by the *mudharabah* fund above his capital contribution.<sup>64</sup> Hafeez also further argued that the incorporation of a company as a legal person with the limited liability of its members is not against the injunctions of Islam. This is because this modern corporation is structured based on the mutual consent of the contracting parties, similar to those in partnership.<sup>65</sup> El-Gari, on the other hand, argued that the analogy of the concept of limited liability could be made with the limited liability of the master of *al'abd al-ma'dzun* (authorised slave) to do business using his master's capital. The income gained from the business will be given to his master. When he incurs debts that cannot be settled, the creditors can sell him to recover the unsettled debts. If such recovery is still insufficient, they cannot go against his master for such claims. In this case, the master owns the slave but not the assets gained in the latter's course of business since they are owned by the slave. Yet, his liability toward the debts of the slave incurred in the business is still limited.<sup>66</sup>

However, several scholars are against the practice of limited liability. For instance, Al-Baqmi argued that under Shariah, the shareholders are liable for the corporation's debts owed to the creditors because such debts are attached to their liability. In addition, the transfer of property by the shareholders to the corporation as a legal entity does not change their status as the actual owners of such property because the recognition of corporation as *dhimma* under the Shariah cannot be treated equally (in isolation) with human beings since the corporation represents the members in managing their affairs in the corporation.<sup>67</sup> Similarly, Fahmi argued that invoking limited liability in *sharikah al-musahamah* is incompatible with the general principles of *sharikah* that all partners are liable for any losses and obligations

<sup>64</sup> Wahbah Al-Zuhaili, *Al-Fiqh Al-Islami Wa Adillatuhu*, Vol. 4, (Damascus, Syria: Dar Al-Fikr, 1986), 881.

<sup>65</sup> Malik M. Hafeez, "An Analysis of Corporate Entity and Limited Liability in Islamic and Western Perspectives of Corporate Governance," *International Journal of Business, Economics and Law* 2, no. 3 (2013), 104.

<sup>66</sup> Muhammad Ali El-Gari, "Athar Al-Ikhtilaf Baina Al-Shakhsiyyah Al-Tabi'iyyah Wa Al-I'tibariyyah Fi Al-Ahkam Al-Fiqhiyyah Li Mustajiddat Al-Masrafiyyah Al-Islamiyyah," in *5<sup>th</sup> Shura Fiqh Conference 2013* (Kuwait, 2013), 278.

<sup>67</sup> Salih Zabin Al-Marzuqi Al-Baqmi, *Sharikat Al-Musahamah Fi Al-Nidzam Al-Saudi* (Saudi Arabia: Jamia'h Umm Al-Qura, 1987), 214-215.

arising from *sharikah* and their liabilities are unlimited, and surely gives harm to creditors in claiming their rights against the corporation.<sup>68</sup> Basyuni also viewed that since the partners are the actual *dhimmah* of the corporation, they are liable for debts incurred by the corporation in accordance with their respective capital ratio if they fail to satisfy the creditors.<sup>69</sup>

Besides that, Al-Haqil views that *mudharabah* does not in any way support limited liability. Undeniably, in the normal course of business, the *rabbul mal* is not liable for any liability arising from the *mudharabah* beyond his capital investment in two situations: when it is duly caused by the *mudharib*'s negligence or misconduct; or when it is done below or within the capital invested. In contrast, if the *mudharib* conducted any transactions that incur more capital exceeding its initial capital investment and the *rabbul mal* has consented to it, he will therein be liable for any losses arising from such transactions.<sup>70</sup> Having said this, although he prefers the permissibility of limited liability under the Shariah, he proposed that such permissibility must be restricted with two conditions; it must be free from any fraud committed by the shareholders in avoidance of liability, or all the shareholders equally bear the losses in the corporation in proportion to their capital contribution.<sup>71</sup> His proposal for these two conditions indicates that piercing the corporate veil may be invoked by proving fraud or adopting joint and several liability principles in *sharikah*.

As far as the argument of *al-'abd al-ma'dzun* is concerned, Al-Qarahdaghi rebutted El-Gari's argument that the slave owns the assets is disputed among the classical scholars whereby the majority of them view that a slave does not own the property as he is also owned by his master. In addition, all the classical scholars agree that the master owns

<sup>68</sup> Husain Kamal Fahmi, "Al-Sharikat Al-Hadithah Wa Al-Sharikat Al-Qabidhah," in *Majallat Majma' Al-Fiqh Al-Islami Li Mu'tamar Majma' Al-Fiqh Al-Islami*, 14<sup>th</sup> Sess. (Saudi Arabia: Munadзамah Al-Mu'tamar Al-Islami, 2003), 464.

<sup>69</sup> Basyuni, *Mabda' Hurriyyat Tadawul Al-Ashum Fi Sharikat Al-Musahamah*, 14.

<sup>70</sup> Abdullah Muhammad Al-Haqil, "Al-Masuliyyah Al-Mahdudah Fi Al-Sharikat Dirasah Ta'siliyyah Tatdbiqiyyah," *Majallah Al-'Adl* 25 (2019), 347-349.

<sup>71</sup> Al-Haqil. 355-356.

the slave's assets.<sup>72</sup> Nyazee argued that the authorised slave is acting as an agent of the master. In fact, the capital possessed by him to do business is owned by the master. The liability of the master for the debts of the business is unlimited when the slave's transactions involving credit purchases are lawful in the sense that it is authorised by the master. The liability of the master is limited only when such transactions are unlawful.<sup>73</sup>

Notwithstanding the above discussions, contemporary scholars agree that incorporating a company with unlimited liability is permissible.<sup>74</sup> For Al-Bashir, this feature complies with the general principle of *sharikah*.<sup>75</sup>

#### **iv. The concept of shares in *sharikah al-musahamah***

Contemporary scholars also disputed the concept of shares in a *sharikah al-musahamah*. The majority of them viewed that under the Shariah, a share represents an *hissah shai'ah* (undivided share) in the capital of a corporation, just as it represents an undivided share in its assets and the rights associated with it upon conversion of the capital into tangible things, benefits, debts and so on. This view is premised on that fact the *sharikah al-musahamah* resembles *sharikah al-inan*.<sup>76</sup>

In contrast, El-Gari refutes their opinion and argues that such a concept contradicts the correct concept of shares under the law. In reality, a share is a property right which represents the holder's ownership in the *sharikah al-musahamah* and no more. His view is based on the fact that *sharikah al-musahamah* is not similar to *sharikah*

<sup>72</sup> A'li Mahyuddin Ali Al-Qarahdaghi, *Buhuth Fi Fiqh Al-Bunuk Al-Islamiyyah*, 1st edn, (Vol 6, Isdarat Wazarah Al-Awqaf wa Al-Shuun Al-Islamiyyah Qatar, 2010), 217.

<sup>73</sup> Nyazee, *Islamic Law of Business Organization: Corporations*, 171-172.

<sup>74</sup> Islamic Fiqh Academy, *Resolutions and Recommendations of The Council of the Islamic Fiqh Academy 1985-2000*, 1st edn (Islamic Development Bank, 2000), 130.

<sup>75</sup> Ahmad Al-Saidq Al-Bashir, "Al-Sharikah Fi Al-Fiqh Wa Al-Qanun" (Jami'ah Al-Quran Al-Karim wa Al'Ulum Al-Insaniyah Sudan, 1999). 207-208.

<sup>76</sup> Al-Qarahdaghi, *Buhuth Fi Fiqh Al-Bunuk Al-Islamiyyah*, 215-216.

*al-inan*, and any attempt to equate the two will lead to a misleading ruling under Shariah.<sup>77</sup>

For Al-Shubaili, a share represents undivided shares of the *sharikah al-musamahah*'s assets in secondary level. He argued that this view takes a moderate approach between the above two views.<sup>78</sup> Despite this, he highlighted that this divergence of views on the concept of shares from a Shariah perspective results in different Shariah rulings in certain aspects such as zakat obligation on the shares, investment in mixed companies with Shariah-compliant and non-Shariah compliant business activities etc.<sup>79</sup>

## OBSERVATION

In general, a company under the CA 2016 adopts the common law principles that always regard the former as a separate legal entity distinct from its members. This is clearly reflected in the House of Lords' judgments in the *Salomon* case, which overruled the findings of the lower courts that the company managed by Mr Salomon is built upon partnership or trust. Lord Macnaghten held as follows:

“The company is at law a different person altogether from the subscribers [shareholders] to the memorandum; and though it may be that after incorporation the business is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or trustee for them. Nor the subscribers as members liable, in any shape or form, except in the manner provided by the Act. That I think is the declared intention of the enactment”.<sup>80</sup>

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<sup>77</sup> El-Gari, “Al-Takyif Al-Fiqhi Li Ashum Sharikat Al-Musamahah.” 198.

<sup>78</sup> Yusuf Abdullah Al-Shubaili, “Qadhaya Mua'sirah Fi Al-Zakat, Zakat Al-Duyun Al-Tijariyyah Wa Al-Ashum Al-Mamlukah Li Al-Sharikat Al-Qabidhah,” in *Buhuth Nadwah Al-Barakah Al-Hadiyah Wa Al-Thalathin Li Al-Iqtisod Al-Islami*, 1st edn (Majmua'h Al-Barakah Al-Masrafiyyah, 2010), 29.

<sup>79</sup> Yusuf Abdullah Al-Shubaili, *Abhath Fi Qadhaya Maliyyah Mu`asirah* (Dar Al-Maiman Li Al-Nashr Wa Al-Tawzi', 2020), 33-54.

<sup>80</sup> [1897] AC 22, 51.

Based on the above judgement, it is clear that a corporation is a *suis generis* species peculiar to the concept of partnership under the common law. For Ireland, a corporation could no longer be viewed as a partnership due to its long transition and evolution into a *sui generis* species in the company law history.<sup>81</sup> Due to this reason, Abbasi contended that any application of partnership principles into the corporation based on the agency theory not only contradicts its legal fundamentals but also creates more legal complications under the company law.<sup>82</sup>

On the same note, it is revealed that partnership under the common law is much closer to *sharikah* under the Shariah as both are almost equivalent in terms of their status as an association between partners.<sup>83</sup> The *sharikah* closely resembles the forms of partnership under the category of *sharikah al-ashkhas*, which focuses more on the individual relationship of partners in a partnership.<sup>84</sup> This assertion is somehow justifiable when Mallat vividly highlighted that corporation is absent in the history of Islamic civilisation, particularly in the Ottoman Mejlle.<sup>85</sup>

Subsequently, it is observed that the recognition of *sharikah al-musahamah* by the scholars under the concept of *sharikah* results in conflicts between both the underlying legal principles of a corporation and the Islamic principles of *sharikah* respectively, in various aspects as follows:

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<sup>81</sup> Ireland, "Company Law and the Myth of Shareholder Ownership." 50.

<sup>82</sup> Muhammad Zubair Abbasi, "Legal Analysis of Agency Theory: An Inquiry into the Nature of Corporation," *International Journal of Law and Management* 51, no. 6 (2009): 415, <https://doi.org/10.1108/17542430911005936>.

<sup>83</sup> Nyazee, *Islamic Law of Business Organization: Corporations*, 39-40.

<sup>84</sup> Abdul Majid Salih Abdul Aziz Al-Mansur, *Iflas Al-Sharikat Wa Atharuhu Fi Al-Fiqh Wa Al-Nidzham*, 1st edn (Vol 1, Dar Kunuz Ishbilila Li Al-Nasr Wa Al-Tawzi', 2012), 66.

<sup>85</sup> Chibli Mallat, "Commercial Law in the Middle East: Between Classical Transactions and Modern Business," *The American Journal of Comparative Law* 48 (2000), 113.

***i) Misconception of sharikah al-musahamah as partnership between the shareholders and the legal entity which represents as their agent***

This contention contradicts the cardinal rule of a separate legal entity of a corporation distinct from its constituents established in the *Salomon* case. Though it is artificial in nature, Kershaw asserts that upon its incorporation under the legal statute, it acts as a real entity or legal reality separated from its members.<sup>86</sup> This is supported by Lord Macnaghten's judgment above that the principle of separate legal personality duly separates both the company and its shareholders despite the fact they incorporated the former under the legal statute, and they remain the same parties who had dealt with third parties prior to or after its incorporation.

This is also supported by Abdul Malik Ishak J's judgment in *Tham Kim Fai v Ng Kon Seong* [2006] 4 CLJ 634 as follows:

“This means that, unlike a company, a partnership is simply a relationship governing the rights and duties of the partners and their relationships with the rest of society. The main difference between a partnership and a company is this. A partnership does not confer any limited liability on the partners. Thus, a partner is liable without limit for the debts incurred by the other partners in the course of the partnership business”.<sup>87</sup>

In parallel, the above contention also contradicts the Islamic principle of *sharikah*, whereby the latter connotes a partnership between two or more individual partners in sharing capital and profit. There must be at least two partners to form a valid *sharikah*; otherwise, such a contract would be invalid. It is this relationship founded on *wakalah* that creates a business entity inseparable from its partners deemed as one *dhimmah*. Conversely, a corporation as a separate legal entity distinct from its members can even be incorporated by a single shareholder under Section 9(b) of the CA 2016. In addition, the writer observes that assuming the company acts as the members' agent while maintaining the company alone to bear the debts and liabilities, such

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<sup>86</sup> David Kershaw, *Company Law in Context Text and Materials*, 2nd edn (Oxford University Press, 2012), 30.

<sup>87</sup> [2006] 4 CLJ 634, 638.

contention contradicts the above Islamic legal maxim of *al-ghunm bi al-ghurm* as explained above.

***ii) Misconception of sharikah al-musahamah as a partnership between the shareholders inter se based on its constitution who own the assets of sharikah al-musahamah based on co-ownership***

This contention also contravenes the legal attributes of a corporation in several aspects. First, the corporation is not built upon a partnership contract among its members internally. Blair argued that the separate entity status of corporations transforms the relationships among corporate participants in ways that cannot be simulated through a collection of contracts.<sup>88</sup> In *Gaiman v National Association for Mental Health* [1971] Ch 317, Megarry J held as follows:

“...in the case of a company, whether limited by shares or guarantee, a new legal entity comes into existence, namely, the company; and many of the powers have to be exercised for the benefit of that entity. This distinguishes a company from an ordinary club, which is not a legal entity distinct from its members...the conversion of a club into a limited company is no mere formality, but a change of substance. Where there is corporate personality, the directors or others exercising the powers in question are bound not merely by their duties towards other members, but also by their duties towards the corporation”.<sup>89</sup>

Second, Talbot asserts that judges adopted and applied the partnership principles in the context of company law upon proof of facts in very limited cases. However, such application only occurs to both company and members, not among the internal individual members where the enforcement of their rights against each other is not based on partnership law. In addition, the law indicates that the contractual model has no place in the law relating to the company constitution. While the language of contract is often used, the company is understood to be a creature of statute and regulation, not of

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<sup>88</sup> Margaret M. Blair, “The Neglected Benefits of the Corporate Form: Entity Status and the Separation of Asset Ownership from Control,” 2004, 46, <https://ssrn.com/abstract=563307>.

<sup>89</sup> [1971] Ch 317, 330.

contract.<sup>90</sup> Regardless of this contention, Cheang articulated that a company may be viewed as a ‘quasi-partnership’ based on trust and confidence among the members upon the application of compulsory winding up on the ‘just and equitable’ ground in Section 465(1)(h) of the CA 2016, which provides an exit for a member from a corporate relationship.<sup>91</sup> This concept is illustrated in *Ebrahimi v Westbourne Galleries Ltd* [1973] AC 360, where Lord Wilberforce held that the term ‘quasi-partnership’ is just a convenient label to justify the application of equitable principles of partnership laws. Indeed, how small and domestic the company is, it is a company, not a partnership or a quasi-partnership. It indicates that such an application is a question of facts that must be proved before the court.

Third, Robe articulated that company’s property is not the members’ one, as there is a misconception of shareholders as owners. What shareholders own are shares issued by the corporation, and the corporation owns the assets. But no one owns the corporation-in-itself.<sup>92</sup>

This assertion is parallel to the above legal principle held by the Federal Court in *Public Bank Bhd* that by separate legal entity principle, the shareholders had no legal or equitable right to the company’s assets. The assets of a company do not belong to a shareholder.

Similarly, Rutledge significantly highlighted that an individual shareholder is not an agent of the corporation nor the entire body of shareholders. He cited Cook’s statement that the mere fact that he is a stockholder does not make him an agent to contract for it or bind it by his acts.<sup>93</sup> In fact, the property of the corporation is that of the corporation; it is not the property of the shareholder and according to McClellan, J’s judgment in the Alabama Supreme Court case of *Harton*

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<sup>90</sup> LE Talbot, *Critical Company Law*, 2<sup>nd</sup> edn (Great Britain: Routledge, 2016), 108.

<sup>91</sup> Loh Siew Cheang, *Corporate Powers Accountability*, 3<sup>rd</sup> edn (LexisNexis Malaysia, 2018), 684-685.

<sup>92</sup> Jean-Philippe Robe, “The Legal Structure of the Firm,” *Accounting, Economics, and Law* 1, no. 1(5) (2011), 27, <https://doi.org/10.2202/2152-2820.1001>.

<sup>93</sup> Thomas E. Rutledge, “A Corporation Has No Soul—The Business Entity Law Response to Challenges to the Contraceptive Mandate of the PPACA,” *William & Mary Business Law Review* 5, no. 1 (2014), 20-21.



*v. Johnston*, 166 Ala. 317, 51 So. 993 (1909), the corporate property is not co-owned (tenants in common) by the shareholders.<sup>94</sup>

On the other hand, the above contention also conflicts with the Islamic principle of *sharikah*, that the partners are *wakil* to each other based on *wakalah*. In addition, the partners always own their respective capital, assets and profits of the *sharikah* based on the principle of co-ownership.

**iii) The board of directors represent as wakil of the shareholders under the wakalah**

In company law, the board acts as an agent of the company, not the shareholders, due to the separate legal entity. Cheang argued that though the directors owe fiduciary duties to members in very limited or special circumstances, the general legal principle is that the directors do not owe any fiduciary duties (as an agent) to the shareholders but to the company itself.<sup>95</sup> In *Percival v Wright* [1902] 2 Ch 421, Swinfen Eady J held that:

“It is urged that the directors hold a fiduciary position as trustees for the individual shareholders and that, where negotiations for sale of the undertaking are on foot, they are in the position of trustees for sale...It was strenuously argued that, though incorporation affected the relations of the shareholders to the external world, the company thereby becoming a distinct entity, the position of the shareholders inter se was not affected, and was the same as that of partners or shareholders in an unincorporated company. I am unable to adopt that view...”<sup>96</sup>

In addition, Robe highlighted that the shareholders could not manage the corporation’s property simply because they do not own it, and therefore, they cannot delegate to officers or directors an authority they do not own in the first place.<sup>97</sup>

Similarly, this contention also contradicts the principle of *mudharabah* whereby the *mudharib* always remains as the *wakil* of the

<sup>94</sup> Rutledge. 22.

<sup>95</sup> Cheang, *Corporate Powers Accountability*, 173-174.

<sup>96</sup> [1902] 2 Ch 421, 426.

<sup>97</sup> Robe, “The Legal Structure of the Firm.” 33.

*rabbul mal* who owns the capital in the *mudharabah*, based on *wakalah*.<sup>98</sup>

***iv) Justification of limited liability under the concept of mudharabah***

This contention clashes with the fundamental rule of *sharikah* that the liabilities of partners are always unlimited. In addition, as articulated by Al-Haqil above, under the *mudharabah*, the liability of *rabbul mal* is also unlimited. Justifying this legal feature under the concept of *sharikah* or *mudharabah* does not only contradict both contracts but also clashes with *al-ghunm bi al-ghurm*, which is fundamentally embodied in the *sharikah*. This contention also violates the Islamic principle of debts, specifically in the rights of the creditors, which is considered a morally and religiously serious matter that is regulated in the Quran and Sunnah.<sup>99</sup>

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<sup>98</sup> Nyazee, *Islamic Law of Business Organization: Corporations*, 164.

<sup>99</sup> Siti Kholifatul Rizkiah and Fajri Matahati Muhammadin, "A Critical Examination towards the Islamic Discourse on 'Limited Liability,'" *UUM Journal of Legal Studies* 11(1) (2020): 28.

## CONCLUSION

This article analyses the dissimilarities between the legal concept of corporation under the common law and the concept of *sharikah* under Shariah. Regardless, contemporary Muslim scholars' discussion of the former under the latter's perspective is necessary for ascertaining its Shariah ruling. The result of this discussion reveals that their recognition of the corporation under the *sharikah* concept without critically analysing its legal attributes and structures - that have legal implications to the Islamic principles of *sharikah* itself - is untenable as it would create legal complications in the company law and Shariah.

Moreover, the incorporation of Shariah-compliant business entities under the corporation is contentious as it sets out its legal principles in the company law, which is not consonant with the Islamic principles of *sharikah* as highlighted above and, thus, creates a vague status of such Shariah-compliant businesses.

From the perspective of business sustainability, highlighting these differences is necessary to revisit the extent that the current legal framework of a company can achieve Goal 10 of the SDGs. While it is clear that its main traditional legal attributes, i.e. separate legal entity and limited liability, are greatly criticised for not achieving this goal due to its design only for shareholder primacy and insulation of their liabilities from the company's immoral actions toward external parties such as creditors etc., the contemporary scholars' opinion of its resemblance to *sharikah* must also be revisited as the latter sets its own Shariah principles and objectives that are not solely profit-driven but also socially centred.

In addressing this conundrum, revisiting the existing legal concept of a corporation under Shariah is necessary, notably to support the above sustainability agenda. Certain modifications to its legal attributes and structures are needed to be compatible with the Islamic principles of *sharikah* and the Islamic ways of conducting businesses, not the other way around as the existing conventional mainstream. This may include *inter alia*, first, the corporation must be recognised as a quasi-business entity under the concept of *al-dhimmah* inseparable from its partners. This reflects the concept of quasi-partnership as introduced by the Ebrahimi case. The difference between the two is that the latter entails a fact-based proof to invoke the same, while the former is perceived as a default rule.

Second, there must be a clear relationship of *sharikah* between the entity and its partners and between the partners internally. Third, a joint/dual ownership of assets between the company and its partners must be ascertained to reflect the effect of *sharikah*. Lastly, a pro-rata liability among the company's partners in accordance with their capital contribution must also be determined.

Nonetheless, this modification is only an interim proposal or recommendation. Furthermore, such a recommendation would be suitable for private companies requiring further deliberations on public companies. This would necessarily require mass efforts from others to accomplish this in the long run, such as an introduction to a new legal framework or concept of a corporation that is structured in accordance with Shariah under the *sharikah* concept. Such introduction requires further research studies and invites other researchers to embark on this new approach in providing a suitable avenue for Shariah-compliant businesses.