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ANALYSIS ON THE DOCTRINE OF LIMITED LIABILITY UNDER COMPANY LAW AND *SHARĪ'AH*

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Abstract

Under company law, the doctrine of limited liability is applied to promote economic development via a legal entity. The main advantage of a limited liability is that it enables business owners to reduce and transfer the risks in business to their company. However, the application of limited liability is often criticized for causing unfairness to creditors. Under English common law, which is the basis of Malaysian company law, a body corporate is recognized as a legal person distinct from the owners. The metaphor of corporate personality is used to justify the attributes of a company as a legal person and its ability to limit liability of its members. However, such principle is not found in Sharī'ah business entities because under Islamic law, a business entity is not separated from the owner and as such, the owner cannot totally transfer the business risks to the business entity. A doctrinal analysis was carried out to analyze the application of the doctrine of limited liability under Malaysian company law and to compare it with the Sharī'ah principles dealing with limited liability. The purpose of this paper is to indicate whether the limited liability regime, which is conferred to conventional companies in Malaysia, could be directly applied to Malaysian companies which are carrying out Sharī'ah-compliant businesses.

Keywords: Company, Limited liability, *Sharī'ah*

Introduction

In Malaysia all companies are regulated under the Companies Act 2016. The Act is based on the common law principle which recognizes companies as a legal entity with rights and attributes of a body corporate. Under common law, a company is regarded as a non-human entity which has rights as a legal person.¹ In Section 3 of Companies Act 2016, a company is defined as “any body corporate formed or incorporated or existing within Malaysia or outside Malaysia and includes any foreign company”. Once a company has been incorporated, it will be recognized as “a legal person and has the right to sue and to be sued, own a property in its name and (to be) separated from the shareholders.”²

The doctrine establishing the legal status of a company as a juridical person is the doctrine of corporate personality which is applied in Malaysian company law via the Companies Act 2016. Under Section 20 and Section 21 of the Companies Act 2016, it is clearly stated that upon incorporation, a company shall become a body corporate and has the attributes of separate legal entity, perpetual succession, ability to enter legal proceeding and the right to acquire property.

In *Macaura v. Northern Assurance Co. Ltd.* [1925] AC 619, the Court held that despite holding all the shares in the company, the defendant only “owned” his shares and a share is in no way a representation of the fractional value of the company’s property.

In *Lee v Lee’s Air Farming (1961)* AC 12, the appellant’s husband incorporated a company to carry on the business of spreading fertilisers on farmland (top dressing) from air. He was the majority shareholders, the sole governing director and also employed by the company as its chief pilot. Mr. Lee was killed in an aircraft crash while flying for the company and the court had to decide

¹ Halyani Hassan, Zuhairah Ariff Abd Ghadas, and Nasarudin Abdul Abd 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): 191–98.

² Zainal A. Zuryati, Ahmad N. Azrae, and Mohamed Yusoff, “Separate Legal Entity under Syariah Law and Its Application on Islamic Banking in Malaysia : A Note,” *The International Journal of Banking and Finance* 6, no. 2 (2009): 139–54.

whether the appellant as the widow is entitled to be paid compensation under the New Zealand Workers Compensations Act 1922. The Privy Council held that there is no reason to deny the possibility of a contractual relationship being created between Mr. Lee and the company. The deceased was held to be a worker within the meaning of the Workers Compensation Act 1922 as the company and the deceased were separate legal entities.

One of the consequences of the distinct personality is that a company is able to limit liability of its members up to the amount of their shareholdings or guarantee in the company.³ A member who has fully paid up his shares shall not be liable to contribute further to the company even if the company assets are not sufficient to pay the business debts⁴ and a member who has interest in the company in the form guarantee shall only be liable to contribute to the company's debts up to the amount of his guarantee.⁵

This paper discusses the attribute of limited liability under Malaysian company law and under the *Sharī'ah*. The outcome of this paper will indicate whether the limited liability regime, which is conferred to conventional companies in Malaysia, could be directly applied to Malaysian companies that are carrying out *Sharī'ah*-compliant businesses.

Limited Liability

The concept of limited liability was introduced 200 years ago in order to enable the large scale investment necessary for the Industrial Revolution to take place⁶. With the severance of investment in the business from the management of the business there was a need to consider protection for the investors, who were often individuals with a relatively small amount of capital, from the possible fraudulent actions of the managers of the business. This paved the way for attracting many more investors thereby enabling the growth of the

³ Companies Act 2016; section 10.

⁴ Companies Act 2016; section 10(2).

⁵ Companies Act 2016; section 10(3).

⁶ Zuhairah Ariff Abd Ghadas and Engku Rabiah Adawiyah, "Partners' Limited: Limited Liability in Partnerships Structure: An Overview of the Common Law and the *Sharī'ah*," *Shariah Law Report 1* (2009): 45–57.

business enterprises, as investors were secure in the knowledge that they were protected from any loss greater than the sum they had invested in the enterprise.⁷ Thus, for relatively small levels of risk they could expect potentially great rewards and escape from some of the consequences of the actions of the enterprise. In short, limited liability encourages entrepreneurial risk taking which encourages economic growth.

Limited liability is normally justified by its economic benefits which include:⁸

- (a) decreased cost to shareholders in monitoring the actions of managers;
- (b) increased incentive to managers to act efficiently and in the interests of shareholders by promoting the free transfer of shares;
- (c) increased efficiency of securities markets since share trading does not depend on an evaluation of the wealth of individual shareholders, only the company itself;
- (d) encouragement to shareholders to hold diverse share portfolios, thereby permitting companies to raise capital at lower costs because of the shareholders' reduced risks;
- (e) facilitation of optimal investment decisions by managers by pursuing projects with positive net present values rather than being concerned with the risk to shareholders that such projects may bring

From the legal perspective, limited liability is a term which has no precise definition.⁹ It is usually used to describe the situation where a person has done an act which, under the prevailing rules of the legal system, will incur a liability but is excused wholly or partly from incurring that liability.¹⁰ Limited liability often arises either because the legal system provides the conveniences under which the parties may organize their affairs so as to achieve limited liability, or because the legal system produces a rule which provides that in

⁷ Ibid.

⁸ Frank H Easterbrook and Daniel R Fischel, *The Economic Structure of Corporate Law* (Harvard University Press, 1996).

⁹ Ben Pettet, "Limited Liability—A Principle for the 21st Century" *Current Legal Problems* 48 (1995): 125–33.

¹⁰ Ibid.

specific circumstances liability shall be limited. There are certain industries which may not exist without special provisions for limited liability for instance, the workers' compensation statutes generally state the limits of liability of employers. Certain treaties such as the Warsaw convention limit the damages for airline passengers, and in the US the nuclear power industry needs the Price-Anderson Act which provides for limitation of liability in the case of nuclear accident.¹¹

The principal arguments in favour of limited liability stems from the common law rule of unlimited joint liability and several liabilities of partners in a partnership.¹² Under the latter principle, partners may be held liable for the whole amount of the firm's debts. The main argument against unlimited liability in partnership is that partners, particularly those who were not involved in committing the default, can be made liable for the loss suffered by the firm due to a default by one or more of the partners. By attaching the liability of the business to all partners as a collective of the firm, no partner can escape from the liability of the business however innocent he or she is.

Limited Liability under Company Law

When companies were first introduced into the market place, they also applied the unlimited liability concept as practiced in partnerships. Up until the middle of the nineteenth century, much trading was still carried on with unlimited liability through various adaptations of the partnership model.¹³ In fact all companies formed under the first English Companies Act were unlimited companies.¹⁴ During that period, shareholders were only allowed to limit their liability as regards the company debts if they entered into separate contracts with the creditors¹⁵ and did not enjoy the protection of

¹¹ Ibid.

¹² N. A. Rahman et al., "Limited Liability Partnership (LLP@ PLT): New Business Vehicle for the Malaysian Legal and Accounting Private Practice.," *Pertanika Journal of Social Sciences & Humanities* 23 (2015).

¹³ Ibid.

¹⁴ Companies Act (7 & 8 Vict, c110).

¹⁵ *Hallett v Dowdall* (1852) 21 LJQB 98.

limited liability automatically upon incorporation. The repeal of the Bubble Act in 1825 and the adoption of the general corporation law in 1844 were not actually responses to the need to limit liability but to the increasing number of unincorporated joint stock companies.¹⁶ The 1844 Act itself emphasized unlimited liability by requiring the registered companies to publicize their members, and the debate on limited liability in the subsequent years after the 1844 Act was carried on almost entirely in terms of partnerships law rather than company law.¹⁷

Limited liability was only made available to private companies via the Limited Liability Act 1855.¹⁸ The main reason for the introduction of the Limited Liability Act 1855 Act was to develop the economy in the UK as many businesses had moved to France and the United States of America where limited liability was available for corporations.¹⁹ The Limited Liability Act 1855 Act was introduced eleven years after the Joint Stock Companies Act 1844 which allowed the creation of companies by registration.

The Joint Stock Companies Act 1844 was later replaced by the Joint Stock Companies Act 1856 and from this Act onwards, growth in the legislation of modern companies which allowed limited liability companies was traceable. It is claimed that the first modern Companies Act was the 1862 Act as it consolidated existing limited companies by share and introduced both limited companies by guarantee and unlimited companies.²⁰ Many legal scholars highlight the fact that the introduction of limited liability in corporations was one of the greatest and the most effective legal inventions of modern times.²¹

In Malaysia the first local statute for company law was the

¹⁶ Graham Peirson, Reporting Entity Concept-Legal Impediment under Corporations Law? *Company and Securities Law Journal*, (1992): 56-363.

¹⁷ John Saville, "Sleeping Partnership and Limited Liability, 1850-1856," *The Economic History Review* 8, no. 3 (1956): 418-33.

¹⁸ John Farrar, *Company Law* (Butterworth, London, 1991).

¹⁹ *Ibid.*

²⁰ *Ibid.*

²¹ Roger E. Meiners et al, Piercing the veil of limited liability, *Delaware Journal of Corporate Law*, Vol 4 (1979): 351.

Straits Settlements Companies Ordinance 1889²² which basically adopted the reforms in company law that occurred in England in the early 1800s. In the Federated Malay States (FMS) company matters were regulated by the Companies Enactment of 1917 whilst in the Unfederated Malay States (UFMS) company matters were regulated by separate Companies Enactments.²³ In 1965 the Companies Act was passed to regulate corporate matters of all the states in Malaysia. The Act was essentially based on the English Companies Act 1948. Hence, it is evident that the principles of law which are applicable under the local Companies Act are similar to the principles of English company law.

The rule of limited liability in a company basically means that the investors in the corporation are not liable for more than the amount they have invested or guaranteed. Members of a limited company by shares cannot be required to further contribute for debts of the company if they have fully paid up their subscribed shares.²⁴ In a company limited by guarantee, the members will only be liable to contribute to the company up to the amount which they have guaranteed.²⁵

The rationale behind the principle of limited liability in companies is that the legal behaviour and performance of the companies are distinct from its members.²⁶ The main objective of this principle is to provide investors some protection in the business over their own personal assets. As such, only the amount paid for the shares and the value of the investment are at risk without taking into consideration their personal wealth and belongings.

Being a body corporate a company enjoys the distinct legal personality, which means members have limited and determined risk in the company. In the event that a company collapses or goes into

²² M. B. Hooker, "The East India Company and the Crown 1773–1858," in *Studies in the History of the Law of Nations* (Springer, 1970), 166–211.

²³ Enactment No. 128 of Johore, Enactment No.41 of Kedah and Enactment No.14 of Kelantan.

²⁴ Companies Act 2016; section 10(2).

²⁵ Companies Act 2016; section 10(3).

²⁶ Hassan, H., Abd Ghadas, Z.A, "Confidentiality of company information: Challenges for nominee directors", *Pertanika Journal of Social Sciences and Humanities*, Vol 25, Special Issue, (2017): 155-166.

liquidation, the members cannot be made personally liable for the company debts regardless of the amount of shareholding. In *Salomon v A Salomon & Co Ltd*²⁷, the House of Lords held that the company's debts cannot be imposed on its controlling shareholders because the company is a legal entity separate from its members, and that the liability of members are confined to their shareholding. In *Abdul Aziz Atan & Ors v. Ladang Rengo Malay Estate Sdn. Bhd.*,²⁸ Shankar J highlighted that:

“It is trite law that an incorporated company is a legal person separate and distinct from the shareholders of the company. The company from the date of incorporation has perpetual succession and the Companies Act provides that the liability on the part of the shareholders to contribute to the assets of the company will be limited in the manner provided by law and its memorandum and articles of association. The whole point of forming a limited company is that the shareholders can have in their hands the management of the business without incurring the risk of being under unlimited liability for the debts of the company.”

Limited Liability under the *Sharī'ah*

Under the *Sharī'ah* all business transactions use a contract as the basis of relationship between the parties involved; hence, the absence of the concept of corporation which is practiced in common law. As noted by Nicholas Foster, the *Sharī'ah* “does not have corporations, only partnerships, which had neither legal personality nor limited liability”.²⁹

The *Sharī'ah* recognizes a wide range of business structures for the purpose of trading, investment and profit-making. One of the structures is *sharikah/shirkah* or *mushārah* whose structure has

²⁷ [1897] AC 22 HL.

²⁸ [1985] 1 CLJ 255; [1985] CLJ (Rep) 370; [1985] 2 MLJ 165.

²⁹ Nicholas H D Foster, “Islamic Perspectives on the Law of Business Organisations II : The Sharia and Western-Style Business Organisations,” *European Business Organization Law Review* 11 (2010): 273–307.

been frequently construed as similar, or at least equivalent, to what is contemporarily termed as partnership. Nonetheless, the term *sharikah* or *mushārahah* actually connotes a wider meaning than that of normal partnership as the term may include not only the modern partnership structure, but also any other structure that involves capital contribution and the subsequent profit and loss-sharing, including that of shareholding in modern companies and even certain parts of financing arrangement in a joint venture³⁰.

The literal meaning of *sharikah* is “intermingle” implying the intermingling of properties that form the capital whereby one cannot be differentiated from the other.³¹ A contract of *sharikah* must fulfill the following essential elements as agreed by the majority of jurists:

- a. offer and acceptance by the parties since *sharikah* is essentially a contract
- b. legal capacity of the parties competent to the contract
- c. subject matter of *sharikah* which can be in the form of monetary/ proprietary capital or labour capital

Sharikah

All business transactions in Islam use contract as the basis of the relationship between the parties and there is no concept of a business entity as practiced under common law. In the Middle Eastern countries where *Sharī'ah* is the law of the country, *sharikah* is the only business entity available to carry out a business.

Literally *sharikah* means a mixing of shares (*khalat*) until they cannot be distinguished from one to the other.³² According to Ibn-e-‘Abidin, *sharikah* is defined as a contract between two or more people for participation in a business capital and its profit.³³

³⁰ Zuhairah Ariff et al., “The Development of Partnership Based Structure In Comparison to the Concept of *Mushārahah* (*Sharikah*) with Special Reference to Malaysia,” no. 2 (2011): 307.

³¹ Wahbah Al-Zuhaily, *Al-Fiqh al-Islamiy wa Adillatuhu*, 3rd. edition (Beirut: Dar al-Fikr, 1989).

³² Burhanuddin Susanto, “Pendapat al-Mazāhib al-Arba ‘ah Tentang Bentuk *Syirkah* Dan Aplikasinya Dalam Perseroan Modern,” *De Jure : Jurnal Hukum Dan Syar’iah* 6, no. 1 (2014): 10–19.

³³ Malik M. Hafeez, “An Analysis of Corporate Entity and Limited Liability in Islamic and Western Perspectives of Corporate Governance,” *International Journal*

Generally, there are two types of *sharikah* namely, *sharikah al-milk* (non-contractual) and *sharikah al-'aqd* (contractual)³⁴.

Sharikah al-'aqd is subdivided into various categories by the jurists depending on a number of factors.³⁵ If the underlying factor is the subject matter of capital contribution, *sharikah al-'aqd* can be subdivided into three main categories; *sharikah al-amwāl*, *sharikah al-a'māl* and *sharikah al-wujuh*. If the subject matter of the capital is money, it becomes *sharikah al-amwāl* (monetary partnership); if the capital is in the form of labour, it becomes *sharikah al-a'māl* (labour partnership); if the capital is in the form of reputation or creditworthiness, it becomes *sharikah al-wujuh* (reputation partnership). The jurists also make further subdivisions to *sharikah al-'aqd* based on the terms of the contract that is, whether the partners are required to contribute equally to the capital and enjoy full equality in exploiting the capital and sharing the profit. Based on this consideration *sharikah al-'uqud* can be divided into two types; *sharikah al-mufāwadah* and *sharikah al-'inan*.

Sharikah al-mufāwadah means an unlimited investment partnership whereby each partner must contribute equally to the capital and enjoy full and equal authority to transact with the partnership capital or property. The Hanafi school considers each partner as an agent (*wakil*) in the partnership business who stands as surety (*kafil*) for the other partners. The partners can be made jointly or severally responsible (*wakil*) for the partnership business and stand as surety (*kafil*) for the other partners. The partners can thus be made jointly and severally responsible for the liabilities of their partnership business provided that such liabilities have been incurred in the ordinary course of business.³⁶ This type of *sharikah* clearly implies unlimited liability on the part of partners since they are both agents and guarantors of each other.

On the other hand, *sharikah al-'inan* can be loosely defined as

of Business, Economics and Law, 2, no. 3 (2013): 104–7.

³⁴ Susanto, "Pendapat *al-Mazāhib al-Arba'ah* Tentang Bentuk *Syirkah* Dan Aplikasinya Dalam Perseroan Modern."

³⁵ *Ibid.*

³⁶ Ghadas and Engku. "Partners's Limited-Limited Liability in Partnership Structure: an Overview of the Common Law and the *Sharī'ah*." no 1. (2009): 50

a limited investment partnership whereby each partner may only transact with the partnership capital according to the terms of the partnership agreement and to the extent of the joint capital. Hence, their liability towards third parties is several but not joint.³⁷ In other words, the liability of partners in *sharikah al-'inan* resembles that of modern-day limited liability partnerships.³⁸

In contemporary Islamic banking and finance, the most common and widely used model is *sharikah al-'inan* compared to *sharikah al mufāwadah*. *Sharikah al-mufawadah* is rarely opted for its higher degree of responsibility and the practical difficulty of achieving full equality between the partners in all aspects of the partnership. Another commonly utilized contract is *muḍārabah* which some jurists consider distinct from the other forms of *sharikah*.

Under the *Sharī'ah*, the paramount consideration in determining liability is not based on the business structure but on the actual *sharikah* contracts between the parties. If the parties want limited liability in business, they can choose *sharikah al-'inan* or *muḍārabah*. If they want unlimited liability, they can choose *sharikah al mufāwadah*. Thus, from the foregoing discussions we can see that the origin of the limited liability regime in *sharikah* is the contract between the parties and not the business structure opted for. It is also noteworthy that “liabilities” in *sharikah* normally refers to contractual obligations. The discussion on liabilities of partners in *sharikah* in the event of liabilities exceeding the assets has not been elaborately made in the classical Islamic law literature. What has been mentioned is merely the general principle which denotes that liabilities follow the amount of capital contribution. This lack of elaborate discussion is understandable because the way Islamic economics and business works ensures a built-in mechanism against excessive mismatch in asset and liability ratio.

³⁷ Ibid.

³⁸ Abd Ghadas and Engku Ali, “The Development of Partnership Based Structure in Comparison to the Concept of *Musharakah (Sharikah)* with Special Reference to Malaysia.” No. 2 (2011) : 311.

Observation

A corporation under common law is based on the doctrine of body corporate which entails upon it some special attributes as an artificial person separate from its founder. The *Sharī'ah*, on the other hand, bases the existence and validity of a business structure upon contractual principles such as *wakālah* and *kafālah*.

The concept of *shirkah 'inan* has been used by *Sharī'ah* scholars to define companies in many Islamic countries. Various types of *shirkah 'inan* are reflected in a company under common law such as *sharikah al-tawsiyyah al-basitah* for a company limited by guarantee; and *sharikah al-musahamah, al-tawsiyyah bil-asham*, and *zatul mas'uliyah al-mahdudah* for a company limited by share. The shareholders of these companies have limited liabilities according to the portion of shares held.³⁹

One of the consequences of the common law principle of limited liability is that when a company is wound up, the members are not liable for its debts as they are only liable to contribute up to the amount of their shareholding. This principle is not applicable in unincorporated business entities such as the partnership which is akin to *sharikah*. Thus, an issue which arises is whether the common law principle of limited liability of members in a company as regards to liability for the business debts is compliant with *Sharī'ah* principles.

In a business, there are various ways in which funds may be raised to meet the needs and funding requirements of individuals and organizations. Normally, debts are subjected to contractual terms with regard to the amount and timing of repayments of principal and interest. The creditor who owes money to the debtor is putting himself at risk if there is a default of payment by the debtor. The most common practice is for the debtor to put some collateral assets as a security for the loan. For the repayment of debt, the debtor needs to pay not only the principal amount owed by him but also the interest as the fee paid by the borrower to the lender. The payment of interest is practiced in the conventional system but expressly prohibited under *Sharī'ah*.

³⁹ Wahbah al-Zuhayli, *Fiqh dan Perundangan Islam Jilid IV*, trans. by Md. Akhir Hj Yaacob et. al. (Kuala Lumpur: Dewan Bahasa dan Pustaka, 1995), 882-887.

The terms *qard* (loan) and *dayn* (debt) relate to the giving or taking of loans under the *Sharī'ah*. The word *qard* can be defined as an interest-free loan for needy borrowers and is extended on a goodwill basis. Islam encourages Muslims to help one another including by granting *dayn* or *qard*. The Prophet (ﷺ) stated:

“A Muslim is the brother of another Muslim. He should not oppress his brother or hand him over to the enemy. The individual who fulfils the need of his Muslim brother, Allah will fulfill his need. That individual who removes a difficulty from his Muslim brother, Allah will remove his difficulty on the Day of Judgment.”⁴⁰

In Islam to give a loan is better than to give charity and one who takes and repays a loan is better respected than those who receive charity. Islam also commanded Muslims to give and take debt that is interest-free (termed as *qardh hasan*). The fulfillment of one's contractual obligations is a religious duty in Islam and *Sharī'ah* defines specific rights and responsibilities of debtors and creditors. The most important duty of the debtor is to repay the loan in fulfillment of the promise or contract made with the creditor. However, Islam makes a distinction between debtors who default by procrastination and those who default by necessity. The latter deserve compassion and must be given time until he is able to pay the debt. The mandatory obligation to pay debts should be appreciated as a main feature of the *Sharī'ah* which established no distinction between an individual's personal and business behavior; the person should act well in both aspects.

The concept of payment of debts in Islamic law is derived from numerous authority in Islam and one of them is the hadith of the Prophet (ﷺ) which was narrated by Ali (رضي الله عنه) who said that:

“I witnessed the Prophet (ﷺ) settled the (payment) of debt first before a *wasiyyah* (will)”.

This hadith expressly mentions that the payment of debts must be

⁴⁰ *Sahih al-Bukhari*, Vol. 3, Book 46, accessed 12 January 2019, <https://sunnah.com/bukhari/46/3>

given priority over will or *wasiyyah*⁴¹ and underlines the obligation to pay debts. There is also a hadith which highlights that the soul of a deceased Muslim shall not be accepted until all his debts are paid⁴² and emphasizes that the obligation of a Muslim to pay debts shall be extended even after his death. It is obvious that the hadith emphasizes the obligation of a human being (a Muslim) to pay his debts but in a company, the debts of the business are not regarded as debts of the members.

Another observation is that under *Sharī'ah* the discussion on the body corporate as an artificial person is derived from the views of Muslim jurists based on the principle of *shaksiyah i'tibariyah*.⁴³ However, there are two different views among Muslim jurists on the application of the principle *al-shaksiyah i'tibariyah* (artificial person) in a commercial entity: firstly, the view of the modern Muslim jurists recognize the principle of artificial legal entity for Islamic institutions such as mosque, *baitul mal* and *waqf*. The issue on the juristic personality of a company has been discussed by many modern Muslim scholars such as Imran Ahsan Khan Nyazee, Mustafa Ahmad al-Zurqa and Muhammad Abu Zuhrah. According to Imran Ahsan:

“There has been a prolonged debate about the existence of the concept of a fictitious person (*shaksiyah i'tibariyah*) in Islamic law. Most modern scholars insist that this concept was known to Islamic law, while some are doubtful whether Islamic law was aware of the concept, but they rejected it for the system they were dealing with. This does not mean that the concept cannot be accepted in Islamic law”⁴⁴

⁴¹ Wan Noraini M.Salim, *Islamic Law of Succession: A Practical Guide to the Laws of Faraid*, (Kuala Lumpur: Malaysian Current Law Journal, 2012): 38.

⁴² Bensaïd et al., “Enduring Financial Debt : an Islamic Perspective Department of Islamic History and Civilization, Academy of Islamic Studies,” *Middle-East Journal of Scientific Research* 13, no. 2 (2013): 162–70.

⁴³ Abd Ghasas Hassan, and Abd Rahman, "The Myth of Corporate Personality: A Comparative Legal Analysis of the Doctrine of Corporate Personality of Malaysian and Islamic Laws".

⁴⁴ Nyazee Imran Ahsan Khan, *Islamic Law of Business Organization* (Kuala

According to Mustafa Ahmad al-Zarqa:

“If these institutions which exist now recognized fictitious personality existed in the early era of development in *fiqh*, it would be obvious that it would be recognized by the *fuqaha* at that time through legal justifications which are similar to legal justifications of the institution of *daulah*, *bayt al-mal*, *al-waqf*.”⁴⁵

The words “these institutions” refer to Islamic institutions such as *waqf*, *baitul mal* and mosque which are recognized by *fuqaha* as entities. Al-Zarqa and Muhammad Abu Zuhrah held the view that the recognition of an entity other than the human can be justified through the theory of *fiqh* known as *al-dhimmah*.⁴⁶

The term of *al-dhimmah* has been discussed by many Muslim jurists in various opinions. According to Mazhab al-Syafie jurists, *al-dhimmah* is an attribute of human being with duties (*al-ilzam*) and also obligations (*al-iltizam*)⁴⁷. This definition is similar to that of the other three major Mazhab (Maliki, Hanafi and Hanbali) and is considered as the main definition.⁴⁸ Al-Sarakhsi defined it as a fixed attribute of a person accepting obligations and duties. This concept relates to obligation and capacity in *al-ahliyyah* as well. The application of this concept as discussed and applied by the jurists since the early era of the development of *fiqh* does not have the same range of meanings. The majority of the *fuqaha* have acknowledged the existence of entities other than human beings that are entitled to some rights and responsibilities. However, unlike in common law, their discussion concerning the artificial person not only relies on the entity itself but also on whether it is subjected to obligations and

Lumpur: The Other Press, 2002).

⁴⁵ Mustafa Ahmad al-Zarqa, *Al-Madkhal ila Nazariyyat al-Iltizam al-Ammah fi al-Fiqh al-Islami*, (1964).

⁴⁶ Muhammad Abu Zuhrah, *Ahkam al-Tirkat wa al-Mawaris* (Cairo, Dar al-Fikr al-‘Arabi, 1996), 43.

⁴⁷ Al-Makashifi Thoha al-Kabashi, *Al-Zimmah wa al-Haq wa al-Iltizam wa Ta’thiruha bi al-Mawt fi al-Fiqh al-Islami* (Riyadh: Maktabah al-Haramayn, 1989): 90.

⁴⁸ Al-Buhuti, Mansur Ibn Yunus, *Kashaf al-Qina ‘an Matn al-Iqna’*, ed. Mustafa Hilal, vol.3 (Riyadh: Maktabat al-Nasr al-Hadithah, n.d.): 54.

responsibilities as required under Islamic law.

According to al Makashifi Thoha al-Kabashi⁴⁹, the *fiqh* of Islam does recognize the existence of an artificial person (*al-syakhsyah al-i'tibariyyah*) like hospitals, *waqf* and *syarikaat* and imposes on them *al-dhimmah* so as to have certain rights and obligations which are not considered similar to the terms in civil law. The artificial person has the attribute of *al-ahliyyah al-kamilah* similar to human beings with certain rights and obligations.

There are other Islamic jurists who are doubtful about the acceptance of the doctrine of artificial person. Zainal highlighted the fact that the application of the principle of *al-dhimmah* to justify the recognition of an artificial entity under *Sharī'ah* is heavily criticized because it is used to refer to anything which has the attributes of a human being with rights and obligations.⁵⁰ Al-Bazdawi and al-Nawawi opined that *al-dhimmah* is real and cannot be fictitious because *Sharī'ah* only imposes obligations and rights on human beings.⁵¹ Following this argument, the human attribute is the reason a person has rights and obligations.⁵² According to al-Sarakhsi, *dhimmah* is an attribute conferred by God and a trust resulting from a covenant. The fact that *dhimmah* is a covenant between God and the 'abd (servant of Allah) means that it can only be assigned to a natural person.⁵³

Conclusion

The obligation to pay debts in Islam is mandatory and such liability shall extend even after the debtor has died. Common law and the

⁴⁹ Al-Makashifi Thoha al-Kabashi, *Al-Zimmah wa al-Haq wa al-Iltizam wa Ta'thiruha bi al-Mawt fi Al-Fiqh al-Islami* (Riyadh: Maktabah al-Haramayn, 1989): 38.

⁵⁰ Zainal A. Zuryati, Ahmad N. Azrae, and Mohamed Yusoff, "Separate Legal Entity under Syariah Law and Its Application on Islamic Banking in Malaysia : A Note."

⁵¹ Al-Zurqa, *Al-Madkhal ila Nazariyyat Al-Iltizam al-Ammah fi al-Fiqh al-Islami*, Dimashq: Dar al-Qalam, (1999): 102.

⁵² Muhammad Ali Al-Tahanawi, *Mausuah Kashshaf Istilah al-Funun wa al-Ulum*, (Beirut: Librarie du Liban, 1996): 116.

⁵³ Imran Ahsan Khan Nyazee, *Islamic Jurisprudence* (Kuala Lumpur: The Other Press, 2003): 35.

Sharī'ah have a different approach to the principles of limited liability. Civil law recognizes limited liability as one of the attributes of a company which is not applicable in a partnership or in a sole proprietorship. Under the *Sharī'ah*, however, the application of limited liability is based on the contract between the parties and not on the type of business structure.

In *sharikah*, unlimited liability applies when the actual contract gives full equality and authority to the partners thus making one partner the agent and guarantor of the other partners (*sharikah al mufāwahdah*). Anything short of this makes the *sharikah* contract limited and so is the liability. If the parties choose the special arrangement of *muḍārabah*, a unique situation arises where the active partner is the prima facie exempted from financial liability while the passive partner enjoys limited liability.

The common law principles of separate legal entity and limited liability which are embodied in a company are also applicable to the Islamic banking institution.⁵⁴ In *Bank Islam Malaysia Bhd v Adnan Omar & Ors* [1994] 3 CLJ 735, the issue of jurisdiction was brought up by the litigants. A preliminary objection was raised by the defendant that since the plaintiff bank was an Islamic Bank, therefore by virtue of Article 121(1A) of the Federal Constitution, the civil court had no jurisdiction to hear the case. The counter argument was that since the plaintiff was a corporate entity it does not practise a religion and as such the *Sharī'ah* courts do not have jurisdiction. The learned High Court judge dismissed the preliminary objection and stated that Syariah Courts can only decide cases that fall under the State List and where the parties are Muslims. Banking falls under the Federal List and as a corporate entity the plaintiff does not have a religion, hence, it is not subjected to the Syariah court's jurisdiction. Unfortunately, in this case the litigants did not raise the argument whether Islamic Banking Art (IBA) ultra vires Federal Constitution and whether the Islamic banking facilities were *Sharī'ah*-compliant or not.

In *Affin Bank Bhd. v. Zukifli Abdullah* [2006]1 CLJ 438, the High Court judge highlighted the argument that in considering the

⁵⁴ Zainal A. Zuryati, N. Azrae, and Yusoff, "Separate Legal Entity under *Syariah* Law and Its Application on Islamic Banking in Malaysia : A Note": 140.

cause of action, the court is guided by the principle of applicability of civil law as found in the Court of Appeal's decision in *Bank Kerjasama Rakyat Malaysia v. Emcee Corporation*, [2003]1CLJ 625 which was held even though the facility involved was an Islamic banking facility. However, the law applicable is the same law under conventional banking and the same principles as well as procedures should be applied in deciding on the application. In this case issues related to the company are referred to the Companies Act which adopts the English principles of corporate entity.

In *Bank Islam Malaysia Berhad v Helcom Engineering Corporation Sdn Bhd & Ors*, [2011] 1 LNS 1862, the judge held that it is up to the customers to choose whether to take up the offer put forth by the Islamic banks. Once accepted, the sanctity of the Islamic principles in the contract would be upheld by the Court except in the presence of any vitiating factor recognized under the Contract Act 1950.

In *Sigur Ros Sdn Bhd & Anor V. Maybank Islamic Berhad & Anor*, [2018] 1 LNS 669, the Court held that a contracting party cannot avoid a contract solely on the ground that it has breached or contravened the provisions of Islamic Finance and Services Act. However, the financial institution which granted the non *Sharī'ah*-compliant financing product will be subjected to penalty/punishment by the regulatory body for offering a non *Sharī'ah*-compliant financial product. Mohamad Shariff Hj Abu Samah JC took the view that an Islamic contract which is non *Sharī'ah*-compliant is still enforceable like any other contract.

From the precedents, it is observed that for legal issues related to limited liability the main reference of the Malaysia courts is still common law and the trials are under the jurisdiction of the civil courts. Despite the different approaches taken by common law and *Sharī'ah*, it is apparent that in practice the principle of limited liability is acceptable under the *Sharī'ah*. This can be seen in its application in Islamic banking contracts, *muḍārabah* contracts and *mushārah* contracts.

TRANSLITERATION TABLE

CONSONANTS

Ar=Arabic, Pr=Persian, OT=Ottoman Turkish, Ur=Urdu

Ar	Pr	OT	UR	Ar	Pr	OT	UR	Ar	Pr	OT	UR		
ء	ب	پ	پ	ز	ز	ز	ز	گ	—	g	g	g	
ب	ب	ب	ب	ژ	—	—	ř	ل	l	l	l	l	
پ	پ	پ	پ	ژ	—	zh	j	م	m	m	m	m	
ت	ت	ت	ت	س	s	s	s	ن	n	n	n	n	
ث	—	—	ṭ	ش	sh	sh	ş	ه	h	h	h ¹	h ¹	
ث	th	th	th	ص	ş	ş	ş	و	w	v/u	v	v/u	
ج	j	j	c	ض	ḍ	ḍ	ž	ی	y	y	y	y	
چ	—	ch	çh	ط	ṭ	ṭ	ṭ	ة	-ah	—	—	-a ²	
ح	ḥ	ḥ	ḥ	ظ	ẓ	ẓ	ẓ	ال	al ³	—	—	—	
خ	kh	kh	kh	ع	‘	‘	‘	¹ – when not final ² – at in construct state ³ – (article) al - or l-					
د	d	d	d	غ	gh	gh	ğ						gh
ڈ	—	—	d	ف	f	f	f						f
ذ	dh	dh	dh	ق	q	q	k						q
ر	r	r	r	ك	k	k/g	k/ñ	k					

VOWELS

	Arabic and Persian	Urdu	Ottoman Turkish
Long	ا	ā	ā
	آ	Ā	—
	و	ū	ū
	ي	ī	ī
Doubled	ي	iy (final form i)	iy (final form i)
	و	uww (final form ū)	uvv
	و	uvv (for Persian)	uvv
Diphthongs	و	au or aw	ev
	ی	ai or ay	ey
Short	ا	a	a or e
	ا	u	u or ū
	ا	i	o or ö
	ا	i	i

URDU ASPIRATED SOUNDS

For aspirated sounds not used in Arabic, Persian, and Turkish add h after the letter and underline both the letters e.g. جھ jh گھ gh

For Ottoman Turkish, modern Turkish orthography may be used.

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