Net Working Capital versus Net Owner's Equity Approaches to Computing Zakatable Amount: A Conceptual Comparison and Application

Mohamed H. El-Badawi and Sultan M. Al-Sultan

Introduction

Zakah is a form of tax and alms mandated by Islam.[1] The concepts underlying zakah are that the rich are responsible for the poor and the poor have the right to receive zakah.[2] This does not imply that Islam is anticapitalist; in fact, Islam motivates the rich to invest funds so they will not be diminshed by paying zakah. Islam opposes idle savings, as it encourages the investment of funds for increased production, employment, and assistance to the poor.[3] Zakah is ordained by the Qur'an, but its technical details are interpreted by the rules and jurisprudence of Islam.[4]

Mohamed H. El-Badawi is a professor in the Department of Accounting/Law, California State University, Dominguez Hills, Carson, California. Sultan M. Al-Sultan is an associate professor in the Department of Accounting, King Saud University, Riyadh, Saudi Arabia.

[1]The word "zakah" means to grow, to purify, to improve: "Take alms (zakah) out of their property—thou wouldst cleanse them and purify them thereby" (Qur'an 9:103). It is used in the Qur'an and the Sunnah as an obligatory alms (*ṣadaqah*), while the ordinary alms are voluntary. However, zakah is not a tax in the real sense of the term, because it is levied only on Muslims, who pay zakah as a religious duty: "Those who spend their wealth to seek Allah's pleasure and strengthen (the roots of their faith) in their souls" (Qur'an 2:265). For further discussion, see Abdullah Nasseef, *Muhammad: Encyclopedia of Seerah, Vol. II* (London: Seerah Foundation, 1986), 426-7.

[2]"And in their wealth is the right of him who asks, and him who is needy" (Qur'an 51:19).

[3]"Woe to every (kind of) scandalmonger and backbiter, who pileth up wealth and layeth it by, thinking that his wealth would make him last forever!" (Qur'an 104:1-3). One of the vices condemned here is ". . . piling up wealth, not for use and service to those who need it, but in miserly hoards as if such hoards can prolong the miser's life or give him immortality." A. Yusuf Ali, *The Holy Qur'an* (Brentwood, MD: Amana Corporation, 1989), 1698, note 6266.

[4]Nasseef, op. cit., 426, states that the rate of payment, exemption limit, and other rules and regulations concerning zakah are determined by Muslim scholars based on the Prophet's teachings. For example: "All types of capital which have been in the possession of the owner

All economic entities maintain financial records of some kind and prepare financial statements according to generally accepted accounting standards. These records and statements are designed for different purposes and are not necessary for determining the amount of wealth subject to zakah. Many researchers have investigated the methods employed to determine the zakatable amount levied on trade assets (*'urūḍ al tijārah*). These methods may be summarized into two approaches: a) the net working capital approach and b) the owner's equity approach.

This paper investigates the feasibility of using the net working capital approach (i.e., accounting principles) and the owner's net equity approach (i.e., the Saudi system) to determine the zakatable amount of trade assets. It will also show the relationship between the two approaches.

This paper is divided into five sections: a) introducing the principles and conditions of zakah accounting for businesses; b) discussing the net working capital approach and how to determine the growing capital as the basis for ascertaining the zakatable amount by analyzing the elements of working capital and the financial transactions during the year; c) analyzing the owner's equity approach used in Saudi Arabia to determine the zakatable amount; d) applying both approaches to a numerical example; and e) contrasting the growing capital with the zakatable amount.

Principles and Conditions of Trade Zakah (*'Urūḍ al Tijārah*)

There are two types of assets. The first type, which is not subject to zakah, includes those capital assets owned for the purpose of using them in one's business. Examples of such assets are the tools and machines used for production or marketing. The second type, which is subject to zakah, includes those assets manufactured or purchased for making a profit by reselling them.[5]

---

for a full twelve months will be subject to zakah" and "The Prophet clearly stated that no zakah is due on property before a year elapses." Nassef, ibid., 433. Its method of disbursement is clearly stated in the Qur'an.

[5]Zakah is levied on various types of capital that have accumulated a surplus at the end of each year. It is levied annually on capital (not investment) after deducting the necessary expenses at the end of the year. Kahf disagrees with al Qaraḍāwī by subjecting fixed assets to zakah: "He (al Qaraḍāwī) drew an analogy between industrial products and agricultural crops, and therefore exempted all fixed assets of the industries and made the net output (after deducting all expenses) zakatable at 10% or 5% without specifying either ratio, whereas we think that this is a kind of business that falls under the general characteristics of *'urūḍ al tijārah* (business assets). Consequently, zakah must be paid on the net worth including fixed and variable assets." Monzer Kahf, *The Calculation of Zakah for Muslims in North America*,

Theologically, wealth is defined as everything that can be possessed and utilized in a normal way (al Qaraḍāwī 1397/1977, 125). For the trade zakatable amount, wealth consists of cash, inventory, customers' receivables, and marketable securities minus all liabilities related to these items. The wealth subject to zakah, i.e., the zakatable amount, must meet the following conditions (ibid., 130-60; Nasseef 1986, 433):

1. complete ownership, either in the owner's possession (on hand) without any restriction or with someone else but under the owner's control.
2. growing or subject to growing (*namī*)
3. exceeds minimum amount (*niṣāb*)
4. exceeds basic personal and trade needs
5. clear of debt
6. the passage of one lunar year of ownership (note: except agricultural, mineral, oil, and any other extracted item) (al Qaraḍāwī 1397/1977, 161).

In its simplest form, zakah on trade wealth is due on any completely owned property (clear of debt) for resale purposes and growing (not used in business) that lasted for one lunar year and exceeded a minimum amount.

Applying the above conditions in today's business environment is not a simple task. Business entities maintain accounting records and prepare financial statements according to generally accepted accounting standards. These standards were developed for different purposes and are not universal, for every country has its own standards. However, an attempt is made here to utilize the data taken from accounting records to arrive at the zakatable amount.

In accounting terminology, the costs of goods or services incurred while creating an item of future benefit up to the point of its being ready to fulfill its original purpose (use or sale) are capitalized as assets. This item must be owned by the enterprise and have a determinable value. Assets acquired for use in manufacturing, selling, administration, and investment activities are referred to as noncurrent assets, while assets acquired through manufacturing or purchase for resale, or those obtained in the course of trade or business purposes, are defined as current assets.

In Islamic terminology, wealth consists of any money or properties that can be utilized by someone. These assets are either kept for the owner's per-

2d ed. (Brentwood, MD: International Graphics, 1980), 3. His zakah schedule on page 9 reads: item 15, "Private business net worth," item 16, "Share in partnership's net worth," and item 20, "Net worth of industrial business." Nasseef, op. cit., 442 states that ". . . it (zakah) will be levied on all accumulated wealth, including excess of annual earnings over expenditure, which has not been invested in trade or industry and has remained with the owner for one complete year. At the end of the year, all this wealth will be subject to zakah."

sonal and business needs or sold for use by someone else. The former are referred to as retentive or holding assets (*'urūḍ al qinyah*), while the latter are referred to as business or trade assets (*'urūḍ al tijārah*). Retentive assets are similar to noncurrent assets, and trade assets are similar to current assets (Shaḥḥātah, *al Taṭbīq*, 1397/1977, 138).

Accountants use different methods of valuation to adjust for changing prices (i.e., for inflation). Examples of these methods are constant dollar, current value, or a combination of the two. The assets are recorded at cost. Then when prices change, they are valued at either the original cost (historical cost) or adjusted to reflect the price-related changes. There are two accounting approaches for changing prices: constant dollar (general price level changes) and current cost (specific price changes). General price level adjustment uses a general price index, such as the consumer price index. Under current cost accounting, there are two major approaches: current entry price (replacement cost) and current exit price (net realizable value).

Islamic jurists, like accountants, do not agree on which method to use. For example, Jābir ibn Zayd (Abū 'Ubayd 1395/1975, 521) recommends the sale value on the day on which the amount of zakah is determined. Kahf (1980, 15) prefers the lower of the cost or market price.[6] There is another opinion, that of Ibn Rushd (al Qaraḍāwī 1977, 337), which supports the item's historical cost.

Most jurists (ibid., 337) recommend expected sale value. In his *Muḥāsibat al Zakah*, Shaḥḥātah confirms these opinions by valuing working capital items (current assets and current liabilities) at the end of the zakatable year according to its current value (selling price); i.e., expected profits are taken into consideration. Perhaps this is consistent with the theological condition of growing (growing or subject to growing), whether it be real or estimated.

Valuing trade assets (inventory, for example) according to the selling price does not take into consideration the current environment, for there are certain expenses involved, such as commission, advertising, transportation, and others, which were not present to any extent in the past. Therefore the valuing method should be the net realizable value, which is determined by subtracting the expected selling expenses from the sale price. Another opinion (ibid., 337) is to use the wholesale price, since it is easy to sell the item at that price. In layman's terms, this would be the replacement cost at the end of the zakatable year. We agree with this replacement cost concept.

To summarize the above discussion, trade assets subject to zakah are

[6]Kahf recommends a lowering of cost or market for inventories and other current assets. However, he recommends other bases depending on the item, for example, stocks and bonds at market rates on the day of zakah, jewelry at market rates if available, otherwise at historical cost. See Kahf op. cit., 15-20.

represented by the net current assets that have been owned for one lunar year for the purpose of profit (growing or subject to growing) as decreased by the related obligations (free of debt) measured by the net realizable value or the replacement cost method. Therefore, the zakatable amount is related to the concept of working capital (current assets less current liabilities) and growing capital (for the purpose of profit).

Working capital may not meet the debt-free and passage-of-one-year conditions to equal the zakatable amount. In the next section of this paper we will analyze and present the reasons for the above assertion and present the possibility that the growing capital (owned working capital free of debt) may not meet the passage-of-one-year condition due to additional investments during the year. In the following section of this paper we will analyze the differences between growing capital and the zakatable amount and how to measure the latter by adjusting the growing capital.

Net Working Capital Approach

The zakatable amount of trade assets could be determined through the net working capital (current assets less current liabilities) at the end of the accounting period (Shaḥḥātah, *al Taṭbīq*, 1397/1977, 146; Shaḥḥātah, *Muḥāsibah*, 1400/1980, 204). This implies that net working capital is equal to the growing capital which is free of debt and has lasted for one year. This may be accurate if we assume 1) simple activity and 2) a direct relationship between current assets and current liabilities, that is, the current assets are financed by (and only by) capital and short-term liabilities.

During the early days of computing zakah on trade assets, business transactions were very simple, for they took only a short period of time, were mostly based on individual activities, and relied on manual performance. Most trade activities were in the form of proprietorships. But today's business transactions are not so simple. The creation of corporations, the large markets, the tremendous increase and complexity of transactions as well as the advanced technology of manufacturing have all led to the need for capital assets (fixed assets) which can assist in producing and maintaining trade assets.

Also in the past, financing was simple, as it consisted of personal capital or simple partnership. If there was any need for additional capital, it was obtained through short-term financing that took place over short disconnected periods. Therefore any change in financing during one operating cycle (increasing or decreasing of debt) was rare. Today, the vast increase in the size of economic units and large corporations has opened many new avenues for raising capital through short-term and long-term financing. This has subsequently led to increases and decreases in resources during the accounting

period (one year). For example, short-term and long-term liabilities were used to finance both short-term and long-term assets.

It is difficult to relate the sources of funds to the application of funds and to determine a direct relationship between them. Even when a fund's source is designated for a specific application (i.e., long-term financing to acquire a long-term asset), the fund may be left and used for a period of time in the current assets.

From the above, it is clear that the mingling of fund sources (equity, long-term and short-term financing) and the application of funds (current assets which include trade assets and long-term assets not subject to zakah) lead to differences between net working capital and growing capital.

These differences are to be expected, since the concept of net working capital as a basis for determining the zakatable amount was created for a different purpose than that of the growing capital. The purpose of classifying assets and liabilities as current and noncurrent in the balance sheet is to measure the entity's ability to meet its short-term debts from its short-term assets as determined by the current ratio, which is one of the important ratios in financial analysis. This is different from Islam's concept of growing capital, which is the capital as represented in trade assets at the beginning of the year plus the growth realized or realizable at the end of the year. Therefore, net working capital does not meet the conditions of complete ownership and being free from debt, both of which are necessary to determine growing capital.

In summary, we should be careful if we are going to use the net working capital approach to determine the growing capital at the end of the year because:

1. The net working capital at the end of the year will be greater than the growing capital if long-term debt is used to finance current assets.
2. The net working capital at the end of the year will be less than the growing capital if short-term debt is used to finance fixed assets, pay off long-term debt, or reduce the capital stock (dividends).

Net working capital at the end of the year equals growing capital if there is no financing of current accounts by noncurrent liabilities (transaction type 1) and no financing of noncurrent assets, noncurrent liabilities, or owner's equity through current liabilities (transaction type 2). Net working capital at the end of the year is greater than growing capital only if transaction type 1 exists (financing of current accounts through noncurrent liabilities). Net working capital at the end of the year is less than growing capital if any or all of transaction type 2 exists (financing of noncurrent assets, noncurrent liabilities, or owners' equity through current liabilities). Net working capital

at the end of the year will be equal to, greater than, or less than growing capital if both transaction types exist.

From the above discussion, it is clear that the accounting concept of net working capital does not agree with the theological concept of growing capital. Therefore, the net working capital should be adjusted to account for the mingling between the funds' sources and applications in order to arrive at the correct zakatable amount. If the accounting concept of net working capital is used, we suggest the following adjustments:

Net working capital at end of year:

add (+):	short-term debts used to a) finance fixed assets, b) pay off long-term debt, or c) reduce capital stock
subtract (−):	long-term debts used to finance short-term assets (trade assets)
equals (=):	growing capital

Net Equity Concept (Owner's Equity)

In the last section, we discussed the feasibility of using the accounting concept of net working capital to measure the growing capital of trade assets according to the theological concept. The analysis points out that the two concepts are not in agreement. In this section, we analyze the use of the concept of owner's equity to determine the zakatable amount of trade assets and the difference between growing capital and the zakatable amount. Since the owner's equity concept is used in Saudi Arabia to determine the zakatable amount, we will analyze the Saudi system.

The Saudi system determines the zakatable amount through the net equity invested in the current assets (trade assets) according to the Zakah Agency as follows:[7]

First ADD:

1. Paid-in capital (plus owner's account if proprietorship) at the beginning of the year. Any addition during the year is ignored, since it does not meet the "passage-of-one-year" condition.

[7]Saudi Arabia Zakah Agency, code number 2/8443/211, issued 8/8/1392 AH.

2. Retained earnings (prior year earnings) including any reserves or appropriations.[8]
3. Net income for the year before any distributions.
4. Income to be distributed unless it is deposited in a bank under the direction of stockholders. The company has no right to withdraw it or to earn money on it.

From the above, DEDUCT:

1. Net fixed assets at the end of the year after deducting accumulated depreciation and any related debt, but not more than the sum of paid-in capital, retained earnings, reserves, and owner's capital at beginning of the year (1, 2, and 3 above).
2. Investment in another entity.
3. Actual losses for the current year or prior years.

Note that the system removes the increase in cash which resulted from paid-in capital (additional investment) during the year, because the passage of the one year condition is not met regardless of whether it was invested in trade assets (current assets) or in retentive assets (fixed assets). However, the system does not assume this condition on a cash increase caused by the sale of fixed assets during the year. That is because:

a) The increase in cash due to the sale of fixed assets after the payment of its liability during the year is considered to have passed the one year condition and therefore is added to the growing capital at the beginning of the year. This means that (other things remaining the same) the zakatable amount at the end of the year is larger than that at the beginning of the year.
b) If the cash or any trade assets used to purchase or finance fixed assets and to pay off liabilities of growing capital are deducted from capital subject to growing, the zakatable amount at the end of year will be smaller than it was at the beginning.

Therefore in determining the zakatable amount, any new investment (additional paid-in capital) during the year should be deducted from the growing capital at the end of the year as follows:

Zakatable amount = growing capital at the end of the year − net increase in paid-in capital during the year.

[8]Except reserves for end-of-service bonuses if they meet the requirements of the labor law and rule number 1/1381 H.

Applications

Applications of the above concepts are presented in this section utilizing the financial statements of figures I through IV.[9]

FIGURE I

INCOME STATEMENT
FOR THE YEAR ENDED
12/31/1990

Sales		$ 900,000
Cost of Sales		(585,000)
Gross Margin		$ 315,000
Operating Expenses	$ 227,500	
Depreciation	27,500	(255,000)
Operating Income		$ 60,000
Gain from Sale of Land		20,000
Net Income		$ 80,000

FIGURE II

BALANCE SHEETS
As of
12/31/1989 and 12/31/1990

		12/31/1989		12/31/1990
Current Assets		$ 252,000		$ 239,500
Fixed Assets		200,000		451,500
Total Assets		$ 452,000		$ 691,000
Current Liabilities		$ 52,000		$ 111,000
Long-Term Liabilities		190,000		255,000
Owner's Equities				
Capital	$ 100,000		$ 170,000	
Reserves	72,000		72,000	
Retained Earnings	5,000		3,000	
Current Income	33,000	210,000	80,000	325,000
Total Liabilities and Operating Expenses		$ 452,000		$ 691,000

[9]The application of the case is based on that used by Al-Sultan in "The Measurement of Zakah on Trade: An Accounting Analysis," *Journal of Administrative Sciences* 12, no. 1 (1987).

NOTES:

(1) During 1989, current liabilities are attributable to current assets, and long-term liabilities are attributable to long-term assets.

(2) Fixed assets increased due to the purchase of new equipment ($189,000) and the purchase of new land ($100,000), and decreased due to the sale of old land ($10,000) and depreciation ($27,500).

(3) The land purchase was financed by issuing bonds for the amount of $100,000. The equipment purchase was financed by cash ($165,000) and short-term liabilities ($24,000).

(4) Long-term liabilities increased by the issuance of bonds payable ($100,000) and long-term debt ($5,000), and decreased by the payment of long-term debt ($40,000). The long-term debt of $5,000 was used to finance current assets.

FIGURE III

STATEMENT OF NET WORKING CAPITAL As of 12/31/1989 and 12/31/1990

	12/31/1989	12/31/1990
Current Assets	$ 252,000	$ 239,500
Current Liabilities	(52,000)	(111,000)
Net Working Capital	$ 200,000	$ 128,500
Decrease in Net Working Capital		$ (71,500)

FIGURE IV

STATEMENT OF CHANGES IN NET WORKING CAPITAL DURING 1990

Sources of Net Working Capital		
Net Income	$ 80,000	
Add: Depreciation	27,500	
Deduct: Gain on Land	(20,000)	
From Operations		$ 87,500
Cash from Sale of Land		30,000
Issuance of Bonds Payable (for land)		100,000
Issuance of Common Stocks		70,000
Long-Term Debt		5,000
Total Sources of Net Working Capital		$ 292,500

Applications of Net Working Capital		
Purchase of Land (from bonds)	$ 100,000	
Purchase of Equipment	189,000	
Payment of Long-Term Debt	40,000	
Cash Dividend	35,000	
Total Applications of Net Working Capital		$ (364,000)
Decrease in Net Working Capital		$ (71,500)

A–Application of Net Working Capital Approach:

If we use the net working capital in determining the growing capital, we get $128,520, as shown in exhibit I.

EXHIBIT I

THE CONCEPT OF NET WORKING CAPITAL

Net Working Capital at 1/1/1990		$ 200,000
Plus Sources:		
From Operations	$ 87,500	
Cash from Sale of Land	30,000	
Cash from Issuance of Stocks	70,000	
Cash from Long-Term Debt for Operations	5,000	192,500
Less Applications:		
Purchase of Fixed Assets for Cash	$ 165,000	
Purchase of Fixed Assets for Short-Term Debt	24,000	
Payment of Long-Term Debt	40,000	
Payment of Cash Dividend	35,000	(264,000)
Net Working Capital at 12/31/1990		$ 128,500

Note that the net working capital is equal to current assets ($239,500) less current liabilities ($111,000).

But this amount does not represent the debt-free growing capital since the entity used long-term debt to finance the year's current assets. Also, the entity financed fixed assets through short-term borrowing. In other words, there are long-term debts against current assets.

B—Growing Capital:

Even though long-term debt is not related to the elements of current assets, we can compute the growing capital at the end of the year as shown in exhibit II.

EXHIBIT II

THE CONCEPT OF GROWING CAPITAL

Debt-Free Growing Capital at 1/1/1990		$ 200,000
Plus Owned Resources:		
Growing Capital from Operations	$ 87,500	
Cash from Sale of Land	30,000	
Cash from Issuance of Capital Stocks	70,000	187,500
Less Applications of Owned Wealth:		
Purchase of Fixed Assets for Cash	$ 165,000	
Payment of Long-Term Debts	40,000	
Payment of Cash Dividend	35,000	(240,000)
		$ 147,500

The difference between the growing capital and the net working capital of $19,000 ($147,500—$128,500) is due to two reasons:

1. The net working capital includes cash of $5,000 obtained through long-term debt to finance the company's operation. This is not an element of growing capital.
2. A short-term debt of $24,000 was deducted from current assets in computing net working capital even though it was used to finance long-term assets. This is not a use of growing capital.

To avoid these differences, we should be careful when using the net working capital approach to determine the growing capital. Adjustments made to account for the mingling of the fund's sources and applications are necessary. To be specific, in order to determine the growing capital, add to the end-of-the-year net working capital short-term debts used to a) finance fixed assets, b) pay off long-term debt, or c) reduce capital stock, and then subtract long-term debts used to finance short-term assets.

C—Application of the Equity Approach (Saudi System):

The computation of the zakatable amount according to the Saudi system is shown in exhibit III, using data from the financial statements presented earlier.

EXHIBIT III

ZAKATABLE AMOUNT ACCORDING TO THE SAUDI SYSTEM

Paid-in Capital at 1/1/1990	$ 100,000
Reserves (appropriated retained earnings)	72,000
Retained Earnings (12/31/1990)	3,000
Net Income (current year)	80,000
Income to Be Distributed (deposited in a special account and included in current liabilities)	0
	$ 255,000
Less:	
Net Long-Term Debt-Free Assets (12/31/1990)	(175,000)
Zakatable Trade Assets for 1990 (Saudi System)	$ 80,000

Note that in exhibit III the net long-term debt-free assets on 12/31/1990 ($175,000) are limited to the sum of paid-in capital, reserves, and retained earnings ($177,500) as shown in exhibit IV. Note also in exhibit III that the zakatable amount on trade assets for the year 1990 equals the net income for the year. This is not a coincidence, for the Saudi system requires the zakatable amount to be at least equal to the realized growth during the year. This is accomplished by applying the condition of limiting the net long-term debt-free assets to the sum of paid-in capital at the beginning of the year ($175,000). Without this condition, the zakatable amount would have been $77,500 ($80,000 net income less $2,500 used to finance the purchase of long-term assets during the year). This is less than the realized growth, a result which is not consistent with the theological concept.

EXHIBIT IV

NET LONG-TERM ASSETS ON 12/31/1990 (Saudi System)

Long-Term Assets 1/1/1990		$ 200,000
Purchase of Land for Bonds	$ 100,000	

Purchase of Equipment for Cash	165,000	
Purchase of Equipment for Short-Term Liabilities	24,000	
Cost of Land Sold for Cash	(10,000)	
Annual Depreciation	(27,500)	251,500
		$ 451,500
Less Debts on Fixed Assets:		
Long-Term Liabilities 1/1/1990	$ 190,000	
Bonds Payable	100,000	
Short-Term Liabilities	24,000	
Long-Term Liabilities Paid during 1990	(40,000)	(274,000)
Net Long-Term Assets on 12/31/1990		$ 177,500

From the above, this company used all of its beginning-of-the-year growing capital (subject to growing), in addition to other sources, to finance the purchase of fixed assets and to pay off part of its long-term liabilities. The growing capital at the end of the year therefore includes part of the net income and increases in the owner's equity during the year that did not meet the passage-of-one-year condition and, accordingly, not all of the wealth is subject to zakah. This is shown in exhibit V.

EXHIBIT V

TRADE ASSETS SUBJECT TO GROWING

Capital Subject to Growing and Debt-Free 1/1/1990		$ 200,000
Cash from Sale of Land		30,000
Growing Capital		$ 230,000
Less Applications		
Purchase of Fixed Assets for Cash	$ 165,000	
Payment of Long-Term Debts	40,000	
Payment of Cash Dividend	35,000	(240,000)
Excess of Applications over Growing Capital		$ (10,000)

Exhibit V shows that the purchase of fixed assets (retentive assets) and the payment of long-term debts exhausted all of the capital subject to growing at the beginning of the year as well as the cash increase due to the sale of fixed assets (land). Since there are no other sources of funds, it is assumed that the deficit resulted from an excess of application over the sources of

growing capital and was subsequently financed (covered) by the income (growth) during the year. This is shown in exhibit VI.

EXHIBIT VI

Net Income (growth)	$ 87,500
Less Excess of Applications over Available Trade Assets	(10,000)
Net Growth at End of Year	$ 77,500
Plus Increase in Owner's Equity	70,000
Growing Capital at 12/31/1990	$ 147,500

According to the Saudi system, the zakatable amount was determined to be $80,000, which represents the year's net income. But in the earlier section, the growing capital was determined to be $147,500. The difference ($67,500) represents the net increase in the paid-in capital during the year ($70,000) less long-term debt to finance the purchase of long-term assets ($2,500), as shown in exhibit VII.

EXHIBIT VII

Growing Capital at 12/31/1990		$ 147,500
Less Net Increase in Capital Stock:		
Issuance of Capital Stocks	$ 70,000	
–Financing of Fixed Assets or Paying off Debts	(2,500)	(67,500)
Zakatable Amount According to Saudi System		$ 80,000

As mentioned earlier, the increase in cash that resulted from additional paid-in capital during the year is removed (subtracted from growing capital at the end of the year) since it does not meet the passage-of-one-year condition. However, the increase in cash that resulted from the sale of noncurrent assets during the year is not removed (added to growing capital at the beginning of the year) since it is considered to have passed the one-year condition. Also, the cash used to purchase or finance fixed assets and to pay off liabilities is deducted from the growing capital. In other words, the zakatable amount equals the growing capital at the end of the year less the net increase of paid-in capital accumulated during the year.

Summary

In this paper, we introduced three concepts which are important for determining the zakah on trade assets and their applications:

1. Net Working Capital
2. Growing Capital
3. Zakatable Amount

The difference between the first two concepts results from the increased number of transactions and their complexity as well as from the mingling of the sources and applications of wealth. The difference between the second and third concepts is due to the timing of the sources and applications of wealth during the company's life. These differences can be traced to variant theological interpretations, such as what are the conditions for the zakatable amount to be debt-free and the meaning of the passage of one year. The following summarizes the major steps in determining the zakatable amount using the above concepts.

Net working capital
+ Short-term debt used to finance fixed assets and/or reduction of capital stock
− Long-term debt used to finance trade assets (current assets)
= Growing capital
− Net increase in capital stock during the year
= Zakatable amount

In order to facilitate the above computation, we recommend that the one paying zakah keep records to distinguish among the following:

1. Sources of wealth
   - from owner's equity
   - from long-term debts
   - from short-term debts
2. Application of each type of wealth to finance operations (trade assets) and to purchase fixed assets.
3. The term relationships between each type of wealth's source and its application in determining the length of time for each kind of remaining wealth at the end of the year.

References

Abu-Ebied, Abdullah. *Al-Amwal*. Cairo: Maktabat Dār al Fikr: 1395 AH/1975 AC.

Ali, A. Yusuf. *The Holy Qur'an: Text, Translation and Commentary*. Brentwood, MD: Amana Corporation, 1409 AH/1989 AC.

Al Qaraḍāwī, Yūsuf. *Fiqh al Zakāh*, vol. I. Cairo: Mu'assasat al Risālah, 1397 AH.

Al Sultan, Sultan. "The Measurement of Zakah on Trade: An Accounting Analysis." *Journal of Administrative Sciences* 12, no. 1 (1407 AH/1987 AC).

Kahf, Monzer. *The Calculation of Zakah for Muslims in North America*. 2d ed. Brentwood, MD: International Graphics, 1980.

Nasseef, Abdullah. *Muhammad: Encyclopaedia of Seerah*, vol. II. London: Seerah Foundation, 1986.

Shaḥḥātah, Ḥusayn. *Muḥāṣibat al Zakāh: Mafḥūmān wa Niẓāmān wa Taṭbīqān*. Jeddah: al Ittiḥād al Duwalī li al Bunūk al Islāmīyah, 1400 AH.

Shaḥḥātah, Shawqī. *Al Taṭbīq al Mu'āṣir li al Zakāh*. Jeddah: Dār al Shurūq, 1397 AH.