



AZZAD

ASSET MANAGEMENT

Invest with faith

Zakah and Purification Calculation Guidelines

The following are the guidelines adopted by the Shari'ah Advisory Board of Azzad Asset Management ("AAM") in regards to calculating the Zakah and purification amounts for the investment accounts of its Muslim clients:

SECTION 1: Zakah

Zakatul mal (Zakah) is a financial obligation that every Muslim must pay on certain assets that are at or above a certain minimum amount (*Nisab*) and have completed a holding period of 12 lunar months (*Hawl*). *Zakah* is required for every Muslim male and female—whether adult or child, sane or unstable. The *Nisab* of *Zakatul mal* is 85g of gold or its market value on the *Hawl* date. Therefore, any Muslim who owns *Zakatable* assets in the form of cash, cash equivalents, and goods for resale worth 85g of gold or more and has held these assets for 12 lunar months is required to pay *Zakah* on these assets. The market value of 85g of gold on April 30, 2013 was \$4,395.41.*

Since *Zakah* is assessed based on the ownership of *Zakatable* assets, the calculation is based on the financial data of an individual's balance sheet as of the *Hawl* date, not his or her income statement. Expenditures, profits, and losses are not considered when calculating *Zakah*. *Zakah* is not obligatory on wages, salaries, or income at the time of receiving such revenue. One's *Zakah* base equals *Zakatable* assets minus liabilities payable by the *Hawl* date.

AAM calculates *Zakah* every year on investment and retirement accounts held by clients for 12 lunar months. Calculations are usually performed once a year at a predetermined *Hawl* date. The *Hawl* date is usually set for *Sha'aban* 23 of every *Hijri* calendar year, 7 days before the month of *Ramadan*.

Zakah Calculation Methodology:

1. *Khars* means estimation, approximation, or rounding based on the most relevant data available regarding assets. *Khars* can be used to determine whether *Zakah* is owed on such assets and in considering *Hawl* and *Nisab*. At AAM, *Khars* will be utilized to assess the amount of *Zakah* owed on such assets. Assets in the accounts are assumed to be deposited at the beginning of the *Hawl* date and have remained the entire year, regardless of when they were originally deposited. Owners can prorate the *Zakah* amount calculated by AAM for the actual time period they have held such assets in their accounts.

Also, AAM assumes that account owners have *Zakatable* assets equivalent to 85g of gold or more at the date of the *Hawl*.

* e-nisab.com, Accessed April 30, 2013.



2. *Zakah* is owed on all cash, gold, and silver based on their values on the day of the *Hawl*.
3. If the debt is in good standing, the financier of the debt owes *Zakah* every year on the *Hawl* date. The financier does not owe *Zakah* on debt that is in bad standing. However, once the financier recovers the debt, or the debt reverts to good standing, then *Zakah* is owed for one year only, regardless of how many years the debt was in bad standing. *Zakah* on interest-based debt securities including bonds, banking notes, CDs, commercial paper, money markets, and other liquid securities is required and is valued at the principal amount or market value, whichever is lower. However, *Zakah* is not owed on any gain due to accrued interest or market appreciation as it is not recognized as lawful. Such gains should be cleansed and donated to charity. Debt owed and due before the *Hawl* date is deductible from one's *Zakah* base. Debt owed and payable after the *Hawl* date is not deductible from one's *Zakah* base. However, one may deduct debt that is a result of acquiring commercial assets (*Arood Tijarah*) from his or her *Zakah* base. The interest portion of any debt acquired in non-*Halal* way should not be deducted from the *Zakah* base.
4. *Zakah* is only owed on *Halal* and lawful assets (*Mal Mutaqawwam*). No *Zakah* is owed on *Haram*, or unlawful, assets such as liquor, pork, gambling (*Mayser*), interest (*Riba*), stolen money, drug money, bribes, or any other "dirty money." Such assets or monies must be returned to their lawful owners or donated to charity. Owners should resort to repentance and firmly resolve not to approach such a way of earning money again. Only securities of companies deemed to be *Halal* according to the Ethical and *Shari'ah* Investment Guidelines adopted by the AAM *Shari'ah* Advisory Board, by the majority of Islamic scholars versed in the financial field, or by recognized *Fiqh* councils are eligible for *Zakah* (see AAM's Ethical and *Shari'ah* Investment Guidelines).
5. Financial options and derivatives do not represent lawful assets (*Mal Mutaqawwam*) from a *Shari'ah* point of view and are not eligible for *Zakah*.
6. Stocks held for the purpose of trading and benefit from their growth and price appreciations are considered commercial goods (*Arood Tijarah*). Therefore, their *Zakah* base will be valued according to the market values of such securities as of market close on the *Hawl* day.
7. Stocks held for the purpose of deriving an income or for benefiting from dividends are considered capital goods (*Arood Quniah*). Therefore, the *Zakah* base of each share of such a company can be estimated (*Khars*) by reducing total current assets by total current liabilities, and then dividing the net by the total number of outstanding shares. The *Zakah* base will be any amount in excess of zero. More accurate *Khars* methods should be utilized whenever possible.



8. With respect to *sukuk* purchased with the intention to derive income and representing ownership of assets leased for deriving rent as income, only the amount of income held for 12 lunar months or longer will be liable for *Zakah*. *Zakah* is required on asset-backed *Sukuk* that are intended to be used as commercial goods. In these cases, *Zakah* will be assessed on the market value of the *Sukuk* at the time of the *Hawl*. For *Sukuk* that represent debt, *Zakah* is calculated based on book value. The *Zakah* base of hybrid *Sukuk* composed of both debt-based and asset-backed components should be assessed proportionately to the debt segments of the *Sukuk*.
9. *Zakah* is owed on Islamic bank deposits that represent ownership of *Zakatable* assets leased for deriving a rent as income, but only on the amount of income held for 12 lunar months or longer. *Zakah* is not owed on the market value of such assets or such deposits. However, *Zakah* is required on deposits that represent debt notes such as *Murabaha*, *Istisna'a*, *Salam*, and others held for 12 lunar months or longer. The amount of *Zakah* on such notes will be assessed based on their book value.
10. Stocks in client accounts are categorized into commercial goods (*Arood Tijarah*) or capital goods (*Arood Quniah*) based on the intention of AAM's portfolio managers.
11. The *Zakah* of client accounts shall be reduced by the amount of taxes and penalties, if any, that may become due upon liquidation and distribution.
12. Calculation of taxes, if any, that may become due upon liquidation and distribution, will be assessed based on the federal and state tax bracket of the owner of the account. Penalties will be assessed based on the age of the owner of the account.
13. The *Zakah* base shall be further reduced by the purification amount calculated and accrued for all the securities purchased on a daily basis during the year of the *Hawl*. Purification amounts, including all interest from lending earned during the *Hawl*, are not subject to *Zakah*. Account owners should eliminate such amounts by donating them to charities and should not benefit directly or indirectly from such donations.
14. *Zakah* is required on assets that are completely owned and vested for the owners. Complete ownership requires that assets be accessible and disposable by the owners without the interference of others. Assets that are not accessible by the owners are considered incompletely owned and owners are not liable for *Zakah* on such assets. Taxes and penalties levied on accounts upon liquidation and distribution do not hinder the complete ownership of assets.
15. AAM provides *Zakah* and purification calculations only. It is the responsibility of clients to disburse the amount of *Zakah* to their preferred charities or recipients.



16. *Zakah* can be paid in kind from any money clients have in their checking or saving accounts. *Zakah* does not have to be paid from the exact account on which *Zakah* is assessed.
17. Clients bear all liabilities for any taxes and/or penalties they may incur when they withdraw money from their accounts. AAM does not provide tax advice. Clients should consult with their tax advisors for any tax consequences that may result from liquidation or distributions.
18. Retirement accounts, including Traditional Individual Retirement Arrangement (IRA) accounts, Roth IRA accounts, IRA Rollover accounts, Simplified Employee Pension Plan (SEP) IRA accounts, and Savings Incentive Match Plan for Employees (SIMPLE) IRA accounts, are *Zakatable*. The *Zakah* on such accounts is calculated by adding all the *Zakatable* assets, reduced by any taxes, penalties, and purification amounts, then multiplying the net amount by 2.5%.
19. Uniform Gifts/Transfers to Minors Act (UGMA/UTMA) accounts, Coverdell accounts, 529 accounts, and Health Saving Accounts (HSAs) are *Zakatable*. The *Zakah* on such accounts is calculated by adding all the *Zakatable* assets, reduced by any taxes, penalties, and purification amounts, then multiplying the net amount by 2.5%.
20. Qualified retirement plan accounts, including 401(k) & 403(b) plan accounts, profit sharing accounts, defined benefit plan accounts, and cash balance plan accounts, that are vested and accessible by the participants, are *Zakatable*. The *Zakah* on such accounts is calculated by adding all *Zakatable* assets that are vested, reduced by any taxes, penalties, and purification amounts, then multiplying the net amount by 2.5%. Only the accounts that are accessible and disposable by their beneficiaries or owners are *Zakatable*. Accounts that are not accessible by participants unless they resign or terminate are not *Zakatable*. However once accounts become accessible for any reason such as termination or resignation of the participants, then the *Zakah* is owed for one year only regardless of how many years the accounts were not accessible. Of course, the accounts will then continue to be *Zakatable* every year moving forward.
21. Rental property owned for the purpose of deriving income (not for resale) is not *Zakatable* at market value of the property. Only whatever remains from the rent received and saved for one lunar year is *Zakatable*. Similarly, shares or interests of real estate investment trusts (REITs) are not *Zakatable* at market value; however, they are *Zakatable* as income stocks (see item no. 7).



SECTION 2: PURIFICATION

Purification is a cleansing process that involves the donation of income earned from any non-*Halal* business activities by companies in which the shareholder is invested. The purification calculation accrues the portion of income from non-*Halal* business activities allocated to the shares of the companies in client accounts. The investor or his or her agent should not intend to benefit from such activities when the shares of such companies are purchased. Shares are purchased only to benefit from the *Halal* business activities that overwhelmingly form the core business of the company. Although AAM follows strict Islamic guidelines when investing for its clients, it advises its clients to cleanse any income that may have been earned from non-*Halal* business activities by the companies in which they are shareholders. AAM shall provide purification calculation reports to its clients once a year, applying to the past 12 lunar months ending on *Sha'aban* 23 of the *Hijri* calendar.

AAM shall inform its clients of the methodology for calculating purification amounts and disclose to clients that such a methodology is based on estimation (*Khars*).

The purification amount for each account shall be the sum of any interest income earned from cash in the brokerage account and the sum of 5% of the net income of all shares of the companies owned by the shareholder. AAM shall issue a disclaimer to investors that the purification calculation figures are conservative estimates (*Khars*) and that it is likely to be more than the exact amounts of income earned from business activities deemed to be inconsistent with the AAM's Ethical and *Shari'ah* Investment Guidelines. Therefore, AAM shall not be liable for the inaccuracy of such amounts.

Purification Calculation Methodology

1. Purification amounts, including all interest from lending earned during the *Hawl* year, are not subject to *Zakah*. Account owners must eliminate these monies by donating them to charity and should not benefit directly or indirectly from said donations. Scholars recommend not donating such money to build mosques or to print the Holy Quran.
2. AAM calculates purification and accrues it daily on all securities that are owned by its clients.
3. AAM's proprietary purification accounting software calculates the purification by considering the following:
 - a. The number of shares of each security
 - b. The net income per share for each security
 - c. Number of days held for each security



4. AAM provides only the calculation figures for purification. It is the responsibility of the clients to disburse the amount of purification to their preferred charities or recipients.
5. Purification can be paid out from any money clients possess. Purification is not required to be paid from the exact account on which the purification calculation is assessed.
6. Clients bear all liability for any taxes and/or penalties they may incur when withdrawing money from their accounts. AAM does not provide tax advice. Clients should consult with their tax advisors for any tax consequences that may result from liquidation or distributions.

May *Allah* help us all to invest for our eternal life, inspire us to cooperate in good deeds, grant us piety, and make us conscious of Him and Him alone.

Mohamad Adam El Sheikh, Ph.D.
Head of *Shari'ah* Advisory Board

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