

PURIFICATION OF ISLAMIC UNIT TRUST FUNDS: A SHARIAH ANALYSIS ON MALAYSIAN APPROACH

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Abstract

Islamic Unit Trust represents an important integral part of Islamic Capital Market that has been developed throughout the years. They are funds managed in compliance with the Shariah principles and invested only in Shariah approved stocks and other investment instruments. As the rapid development of Islamic capital market, as one of the components of Islamic finance, taken place all over the world, operational issues regarding the implementation of Shariah aspects in Islamic unit trust funds aroused. This article identifies issues regarding the purification of Islamic unit trust fund in Malaysia. These identified issues involved the elements that need to be purified in the context of Islamic unit trust funds; and the implementation of the purification process in some of the Islamic unit trust funds. The result of the conducted study shows that the purification process, by means of zakat and charity, is carried out differently between one country and another. Some countries such as Singapore regulates that the fund manager is responsible for the process. Therefore, the amounts are taken out before the returns are distributed among investors. On the other hand, in some countries, like Malaysia, the purification of the returns is voluntarily done by investors themselves. Scholars are also differ on the elements that needs to be purified, between the dividend, capital gain and assets and liabilities.

Keywords: Islamic unit trust, Islamic Capital Market, Shariah, Purification, Capital Market.

INTRODUCTION

Unit trust fund is defined as a collective investment scheme that pool funds from investors who share the same investment and financial objectives in a trust fund managed by professional investment managers (Rosly, 2004). Conventional unit trust funds differ from the Islamic funds in the sense that these funds are invested in a diversified portfolio of Shariah approved financial assets such as Shariah-approved equities, Islamic bonds, Islamic deposits and Islamic money market instruments (AAOIFI, 2010).

Islamic unit trust funds are approved globally as acceptable Islamic investment products as per the guidelines of the Shariah. The Islamic funds have undergone a stringent screening process by the Islamic finance scholars in the field. The validity of the funds is subject to the condition that instead of a fixed return tied up with their face value, they must carry a pro-rata profit actually earned by the fund. Therefore, neither the principal nor a rate of profit (tied up with the principal) can be guaranteed. The subscribers must enter into the fund with a clear understanding that the return on their subscription is tied up with the actual profit earned or loss suffered by the fund. If the fund earns huge profits, the return on their subscription will increase to that proportion. However, in case the fund suffers a loss, they will have to share it also, unless the loss is caused by the negligence or mismanagement, in which case the management, and not the fund, will be liable to compensate it (Usmani, 2002).

It is noted that the major differences between the Islamic and conventional unit trust funds is the investment avenues, i.e. places where the pooled money is invested. In the Islamic unit trust funds, the portfolio of securities and other assets must comply with the Shariah, which in many jurisdictions must be approved by the Shariah advisory council. This

brings us to the issue of stock screening process or how the Shariah advisory council approved the stock to be considered as Shariah compliant.

The other main differences between the Islamic and conventional unit trusts are contracts which are applicable to the fund and the issue of purification of the income generated from the fund.

SCREENING PROCESS

In the Islamic unit trust operation, the stocks that can be invested in are evaluated by the Shariah Advisory Council (SAC) of the Securities Commission (SC)¹ to determine whether the stock of the listed company complies with the Shariah principles thus rendering it permissible or halal for investment or otherwise.² The main criterion for being classified as halal stocks or Shariah -compliant stocks is that the business of the main company issuing the stock must be totally in accordance with the Shariah principles (SC, 2002). The contemporary Shariah experts are almost unanimous on this point. If all the transactions and business activities of a listed company are fully complied with the Shariah principles and guidelines, then its shares can be purchased, held and sold without any obstruction from the Shariah perspective.

On the contrary, if the company's activities are not in accordance with the Shariah principles, then the stocks of the company are not complying with the Shariah (Laldin, 2008). Consequently, purchasing and selling the stocks are not permissible from the Shariah perspective.

The SAC of the SC has set up certain criteria to verify the unapproved stocks. In formulating the criteria, the SAC of the SC has focused on primary activities of the company with regard to the goods and services offered. This is because these primary activities bring primary returns for the company and are subsequently distributed to the shareholders in the form of profits and dividends.

Therefore, if the primary operations of listed securities or companies are involved with the primary activities that are being listed in the SAC's criteria for non- Shariah compliant stocks and companies, then the stocks will be excluded from the list of Shariah approved stocks. The IISG3, in its fifth meeting on 23 August 1995, outlined four basic primary activities criteria to analyze the listed securities and companies. The criteria are as follows: Companies operations based on interest (riba); Companies operations involve in gambling; Companies operations involve the manufacture and/or sale of haram products; Companies operations contain element of *gharar* (uncertainty).

Majority of company listed in the Malaysian stock market, which is known as Bursa Malaysia, is not fully liberated from the non-permissible elements according to the Shariah principles, such as interest, *gharar*, etc. The SAC of the SC has developed a benchmark for minimal permissibility for investing in these companies. Thus, it can be concluded that a portion of the profit generated from the Islamic unit trust fund investments are generated from non-permissible elements.

Purity in almost every aspects of a Muslim's life, including in one's income and wealth, is a major concern in Islam and Shariah.⁴ This brings us to the question of the need

¹ In Malaysia, the authority responsible for examining and evaluating the activities of companies listed in the stock market for the said purpose is the Shariah Advisory Council (SAC) of the Securities Commission (SC). Readers may log on to www.sc.com.my for more information.

² Stocks that are comply with the *Shariah* principles are termed as '*Shariah-compliant stocks*', whereas stocks that do not comply with these principles are called non-compliant stocks.

³ IISG stands for Islamic Instrument Study Group. It was a committee formed by the Securities Commission of Malaysia (SC) in 1994, prior to the establishment of Syariah Advisory Council of the Commission. The objective from the formation of the group was to discuss and to make decision on issues related to the Islamic Capital Market in Malaysia. According to SC, eight meetings were held by this group throughout 1995-1996. See Securities Commission, Regulation of the Securities Commission Syariah Advisory Council, p.4.

⁴ For this important matter, a few verses in the Qur'an have highlighted the importance of purity in a Muslim's life. As to the purity of one's income and wealth accumulation Allah has said in the Qur'an in Surah al-Nisa' verse no 29: "*O you who believe, eat not up your property among yourselves in vanities; but let there be among you traffic and trade by mutual good-will*".

for purification of those funds, especially the profit generated from those funds. Therefore, this article discusses some issues regarding the purification of Islamic unit trust fund. These issues among others are the concept of purification of property in Islam and the need for purification; what is to be purified in the context of Islamic unit trust funds; and the implementation of the purification process in some of the Islamic unit trust funds.

THE CONCEPT OF PURIFICATION IN ISLAM

One of the most important principles of faith in Islam is that all things belong to God, and the wealth held by human beings is therefore a trust.

In al-Ma'idah, Allah has said:

لَقَدْ كَفَرَ الَّذِينَ قَالُوا إِنَّ اللَّهَ هُوَ الْمَسِيحُ ابْنُ مَرْيَمَ قُلْ فَمَنْ يَمْلِكُ مِنَ اللَّهِ شَيْئًا إِنْ أَرَادَ أَنْ يُهْلِكَ الْمَسِيحَ ابْنَ مَرْيَمَ وَأُمَّهُ وَفِي الْأَرْضِ جَمِيعًا وَلِلَّهِ مُلْكُ السَّمَاوَاتِ وَالْأَرْضِ وَمَا بَيْنَهُمَا يَخْلُقُ مَا يَشَاءُ وَاللَّهُ عَلَى كُلِّ شَيْءٍ قَدِيرٌ

Which means, "In blasphemy indeed are those that say that Allah is Christ the son of Mary. Say: Who then has the least power against Allah, if His will were to destroy Christ the son of Mary, his mother, and all everyone that is on the earth? For to Allah belong the dominion of the heavens and earth, and all that is between. He creates what he pleases. For Allah has power over all things".

This is also based on the principle that the human being is created by Allah. Being a creation, and as Allah has also created everything on earth, all the possessions of human beings therefore belong to Allah. In the Quran, Allah has used the word zakat in explaining the process of purification. The word zakat means both 'purification' and 'growth'. Our possessions are therefore, purified by setting aside a proportion for those in need, and like the pruning of plants, this cutting back balances and encourages new growth.

Purification, according to Al-Gari, means deducting from the returns on one's investment the earnings of the source which is not acceptable from the Shariah point of view (ElGari, 2002). The returns of the Islamic unit trust funds will avoid the non-permissible elements including that of *riba* (interest) through the process of purification (Saw, S.H. & Karyn, W., 2008). In the case of equity investments, which include Islamic unit trust investments, this refers primarily to interest earnings and incidental income from other non-permissible sources of income to investors such as the sale of alcoholic beverages or pork. Estimating earnings from the sale of pork and alcoholic beverages is relatively easy. It is calculating the interest that is quite problematic.

THE BASIS FOR PURIFICATION

The issue of purification is not new to the Islamic economic system. It has a relatively clear Shariah foundation, on the basis of Shariah legal texts, i.e. al-Quran and Sunnah from which the principles for such procedures were derived, and exemplified in the classical annals of al-Fiqh al-Islamiyy and statements of major learned scholars of the early centuries.

In the al-Quran, in clarifying the rules of zakat, Allah has said:

خُذْ مِنْ أَمْوَالِهِمْ صَدَقَةً تُطَهِّرُهُمْ وَتُزَكِّيهِمْ بِهَا

Which means "Of their wealth, take alms (zakat) that so you might purify and sanctify them)".

The word 'tuzakkihim' is derived from the word 'tazkiyyah' which means to purify or to cleanse. Thus, one of the spiritual functions of zakat is to purify one's wealth and property from any non-permissible elements and others' rights to the property. In the verse, the word 'tuzakkihim' is combined with the conjunction 'biha' which means from the said act, i.e. giving zakat, one's wealth will be purified (Ibn Qudamah, 2004).

While the word tazkiyyah is highlighted in the act of giving zakat, other rules in Shariah law are also not excluded from the element of tazkiyyah (purification). For example,

the Shariah rules regarding sacrifice (*tadhiyyah*) during 'eid al-adha, are also meant to purify one's wealth as well as his heart for giving a portion of his wealth to those in need. While one purifies his wealth, giving it voluntarily helps purify his heart by removing the sense of greed and selfishness.

One of the most important tasks for the prophet Muhammad (PBUH) in his mission was to purify the souls. Allah says in the Quran referring to this mission;

هُوَ الَّذِي بَعَثَ فِي الْأُمِّيِّينَ رَسُولًا مِنْهُمْ يَتْلُو عَلَيْهِمْ آيَاتِهِ وَيُزَكِّيهِمْ وَيُعَلِّمُهُمُ الْكِتَابَ وَالْحِكْمَةَ وَإِنْ كَانُوا مِنْ قَبْلُ لَفِي ضَلَالٍ مُبِينٍ

Which means "It is He who sent to an illiterate people a messenger from amongst themselves, reciting to them His signs and purifying them and teaching them the Book and the wisdom even though before they were clearly in error".

It is therefore noted that Islam, since the very beginning, has given major attention to the purification of every aspect of a Muslim's life, including his heart, wealth and property. In the tradition of the Prophet Muhammad (PBUH), numerous texts regarding the principles of the purification of wealth and property are to be found. For example, in a hadith narrated by Abu Hurairah, Prophet has said:

"If one gives in charity what equals one date-fruit from the honestly -earned money and Allah accepts only the honestly earned money -Allah takes it in His right (hand) and then enlarges its reward for that person (who has given it), as anyone of you brings up his baby horse, so much so that it becomes as big as a mountain" (Hadis. Al-Bukhariyy. Book 24, No. 491).

In another hadith narrated by Abu Hurairah, Prophet (PBUH) has reported saying: *"Whoever is made wealthy by Allah and does not pay the Zakat of his wealth, then on the Day of Resurrection his wealth will be made like a bald-headed poisonous male snake with two black spots over the eyes. The snake will encircle his neck and bite his cheeks and say, 'I am your wealth, I am your treasure'. "Then the Prophet recited the holy verses: 'Let not those who covetously withhold of the gifts which Allah has given them of His grace, think that it is good for them; soon shall the things which they covetously withheld be tied to their necks like a twisted collar, on the day of judgement'" (to the end of the verse) (Hadis. Al-Bukhariyy. Book 24, No. 486).*

Clearly, the tradition of the Prophet (PBUH) has given emphasis to the purification of wealth and property. In the above mentioned hadith, Allah gives rewards and doubles them to those who contribute a portion of their wealth to those in need and that is counted as a purification of his wealth. At the same time, He promises his wrath for those who do not want to give anything from their property.

MEANS OF PURIFICATION

Generally, there are two means of purification of property in Islam, they are; zakat and charity.

Zakat

Zakat is a form of giving to those who are less fortunate. It is obligatory upon all Muslims to give a specific portion of wealth and assets each year, in excess of what is required, to the poor and those who are eligible to receive zakat, as mentioned by the Quran. Giving the Zakat is considered an act of worship because it is a form of offering thanks to God for the means of material well-being one has acquired.

Literally zakat means grow (in goodness) or 'increase', 'purifying' or 'making pure' (Al-Qaradawiyy, 2002). The word zakat is derived from the Arabic verb *zaka*, which means increase (*al-nama*) and purify (*al-tuhr*) (Ibn Manzur, 2000). Therefore, the act of giving zakat means purifying one's wealth to gain Allah's blessing to make it grow in goodness. Zakat in technical terms is a certain fixed proportion of the wealth of a Muslim and of each and every

kind of property liable to Zakat to be paid annually for the benefit of the poor in the Muslim community (Al-Qaradawiyy, 2002).

The payment of Zakat is obligatory as it is one of the five pillars of Islam. Zakat is the major economic means for establishing social justice and leading the Muslim society to prosperity and security (Ariff, M., 2005). As it has been mentioned, zakat is mentioned vis-a-vis with salat (prayer) in 30 verses of the Quran. It was first revealed in al-Muzzamil:

إِنَّ رَبَّكَ يَعْلَمُ أَنَّكَ تَقُومُ أَدْنَىٰ مِنْ ثُلُثَيِ اللَّيْلِ وَنُصْفَهُ وَثُلُثَهُ وَطَائِفَةٌ مِّنَ الَّذِينَ مَعَكَ وَاللَّهُ يُقَدِّرُ اللَّيْلَ وَالنَّهَارَ عَلِمَ أَن لَّنْ نُحْصِيَهُ فَتَابَ عَلَيْكُمْ فَافْرُؤُوا مَا تَيَسَّرَ مِنَ الْقُرْآنِ عَلِمَ أَن سَيَكُونُ مِنْكُم مَّرْضَىٰ وَآخَرُونَ يَضْرِبُونَ فِي الْأَرْضِ يَبْتَغُونَ مِن فَضْلِ اللَّهِ وَآخَرُونَ يُقَاتِلُونَ فِي سَبِيلِ اللَّهِ فَافْرُؤُوا مَا تَيَسَّرَ مِنْهُ وَأَقِيمُوا الصَّلَاةَ وَآتُوا الزَّكَاةَ وَقَرِّضُوا لِلَّهِ قَرْضًا حَسَنًا وَمَا تُقَدِّمُوا لِأَنفُسِكُمْ مِن خَيْرٍ تَجِدُوهُ عِنْدَ اللَّهِ هُوَ خَيْرٌ وَأَعْظَمُ أَجْرًا وَاسْتَغْفِرُوا لِلَّهِ إِنَّ اللَّهَ غَفُورٌ رَّحِيمٌ

Which means "Indeed, your Lord knows, [O Muhammad], that you stand [in prayer] almost two thirds of the night or half of it or a third of it, and [so do] a group of those with you. And Allah determines [the extent of] the night and the day. He has known that you [Muslims] will not be able to do it and has turned to you in forgiveness, so recite what is easy [for you] of the Quran. He has known that there will be among you those who are ill and others traveling throughout the land seeking [something] of the bounty of Allah and others fighting for the cause of Allah. So recite what is easy from it and establish prayer and give zakah and loan Allah a goodly loan. And whatever good you put forward for yourselves - you will find it with Allah. It is better and greater in reward. And seek forgiveness of Allah. Indeed, Allah is Forgiving and Merciful" (al-Quran. Al-Muzammil. 20).

In another verse, Allah declares that those who pay zakat, are included within the Muslim society:

فَإِنْ تَابُوا وَأَقَامُوا الصَّلَاةَ وَآتَوُا الزَّكَاةَ فَإِخْوَانُكُمْ فِي الدِّينِ وَنُفَصِّلُ الْآيَاتِ لِقَوْمٍ يَعْلَمُونَ

Which means "But (even so), if they repent, establish regular prayers, and practice regular charity, they are your brethren in Faith: (thus) do We explain the Signs in detail, for those who understand".

Zakat not only purifies the property of the contributor but also purifies his heart from selfishness and greed. It also purifies the heart of the recipient from envy and jealousy, from hatred and uneasiness and it fosters good-will and warm wishes for the contributors

Sadaqah (Charity)

Sadaqah or charity is the other means of purification of property is Islam. While the zakat is made compulsory to the Muslim who possesses the nisab, the sadaqah on the other hand is optional to them.

Sadaqah is a voluntary act of giving alms 'fi sabillillah' (for the cause of Allah), by Muslims who want to contribute more than their obligatory zakah payment. Sadaqah may be given to mark or bring blessings to occasions such as weddings, anniversaries, personal success or even instances of sadness or bereavement. In short, sadaqah can be given during any period of happiness or sadness or as a sign of gratitude to Allah. The importance of sadaqah as a form of purification and growth of wealth has been mentioned by the Quran. For example, Allah has said:

مَثَلُ الَّذِينَ يُنْفِقُونَ أَمْوَالَهُمْ فِي سَبِيلِ اللَّهِ كَمَثَلِ حَبَّةٍ أَنبَتَتْ سَبْعَ سَنَابِلَ فِي كُلِّ سُنبُلَةٍ مِّثْقَالٌ مِّثْقَالُ حَبَّةٍ وَاللَّهُ يُضَاعِفُ لِمَن يَشَاءُ وَاللَّهُ وَاسِعٌ عَلِيمٌ

Which means "The parable of those who spend their substance in the way of Allah is that of a grain of corn: it grows seven ears, and each ear has a hundred grains. Allah gives

manifold increase to whom He pleases. And Allah cares for all and He knows all things" (al-Quran. Al-Baqarah. 261).

الَّذِينَ يُنْفِقُونَ أَمْوَالَهُمْ فِي سَبِيلِ اللَّهِ ثُمَّ لَا يُتْبِعُونَ مَا أَنْفَقُوا مَنًّا وَلَا أَذًى لَهُمْ أَجْرُهُمْ عِنْدَ رَبِّهِمْ وَلَا خَوْفٌ عَلَيْهِمْ وَلَا هُمْ يَحْزَنُونَ

Which means "Those who spend their substance in the cause of Allah, and follow not up their gifts with reminders of their generosity or with injury, for them their reward is with their Lord; on them shall be no fear, nor shall they grieve" (al-Quran. Al-Baqarah. 262).

وَمَثَلُ الَّذِينَ يُنْفِقُونَ أَمْوَالَهُمْ ابْتِغَاءَ مَرْضَاتِ اللَّهِ وَتَثْبِيتًا مِّنْ أَنْفُسِهِمْ كَمَثَلِ جَنَّةٍ بِرَبْوَةٍ أَصَابَهَا وَابِلٌ فَآتَتْ أُكُلَهَا ضِعْفَيْنِ فَإِن لَّمْ يُصِبْهَا وَابِلٌ فَطَلٌّ وَاللَّهُ بِمَا تَعْمَلُونَ بَصِيرٌ

Which means "And the likeness of those who spend their substance, seeking to please Allah and to strengthen their souls, is as a garden, high and fertile: heavy rain falls on it but makes it yield a double increase of harvest, and if it receives not heavy rain, light moisture suffices it. Allah sees well whatever you do" (al-Quran. Al-Baqarah. 265).

In a Hadith narrated by Ibn Mas'ud: I heard the Prophet (PBUH) saying:

"There is no envy except in two: a person whom Allah has given wealth and he spends it in the right way, and a person whom Allah has given wisdom (i.e. religious knowledge) and he gives his decisions accordingly and teaches it to others" (Al-Bukhariyy, 2008).

In another Hadith: The Prophet (PBUH) said:

"Charity is a necessity for every Muslim'. He was then asked: 'What if a person has nothing?' The Prophet replied: 'He should work with his own hands for his benefit and then give something out of such earnings in charity.' The Companions asked: 'What if he is not able to work?' The Prophet said: 'He should help poor and needy persons'. The Companions further asked 'What if he cannot do even that?' The Prophet said 'He should urge others to do good'. The Companions said 'What if he lacks that also?' The Prophet said 'He should check himself from doing evil. That is also charity'.

It is therefore understood that zakat and sadaqah play important roles in the purification of one's wealth and property. They purify not only the wealth and properties from non-permissible elements and others' rights to the property but they also purify one's heart and soul.

ELEMENTS THAT NEED TO BE PURIFIED

Majority scholars agree to the need for a purification process for the investment funds. AAOIFI (2010) in Shariah Standard 5/1/4/3 stipulates that zakat need to be paid from investment funds in their different forms. They, however, have differing views on determining the elements that need to be purified in the process of purification. To the question of what needs to be purified in the context of Islamic unit trust funds, as well as other investment funds, three elements are involved. They are namely; dividend, capital gain, assets or liabilities.

Dividend

Dividend is one the elements that is involved in the purification process in Islamic unit trust funds. Dividend refers to a taxable payment declared by a company's board of directors and given to its shareholders out of the company's current or retained earnings, usually quarterly. Dividends are usually given as cash (cash dividend), but they can also take the form of stock (stock dividend) or other property (Cheong, S., 1994).

Some scholars are of the view that the dividend is the element in the investor's returns that need to be purified. This is because, according to them, the non-permissible

earnings of a company, such as interest, will pass through into an investor's return only if the investor obtains a direct receipt from the company in the form of dividend. (El-Gari, 2002). Returns derived from capital gains, which constitute the bulk of the returns accruing to equity investors, need no purification according to this view. This is because, according to this view, the capital gain is a market element. The main implication of this approach is that no cleansing will need to be applied if no dividend is distributed, even if the company did earn income in the form of interest.

Capital Gain

Capital gain is one of the benefits of investing in the Islamic unit trust funds. Another view in this regard differentiates between investing in a single company and being a subscriber in an investment fund. While it makes sense to purify only dividend incomes, as in the first case, in the second case the fund itself is considered as company where investment units are akin to company shares (Arbi, K.R., 2009).

Capital gain refers to the amount by which an asset's selling price exceeds its initial purchase price. A realized capital gain is an investment that has been sold at a profit. An unrealized capital gain is an investment that hasn't been sold yet but would result in a profit if sold. Capital gain is often used to mean realized capital gain.

In this case, the investment return that is derived from such a fund, which is primarily a capital gain on the underlying shares, must all be purified. As such, returns are not dissimilar to dividends on company shares. This is because no capital gain is realized from the sale of fund units since they are not traded. Hence, any income there from that is distributed is similar to a dividend (Archer, S. & Karim, R.A., 2002).

Assets or Liabilities

Contrary to the second view, this third view holds that the increase in share prices in the market (capital gain) is a complex phenomenon. Such an increase can be attributed to a multitude of factors, from which cash and debt securities (the source of interest earnings) cannot be excluded. Hence, even capital gains ought to be purified.

Current thinking is that only company assets need to be purified. Asset refers to any item of economic value owned by an individual or company, especially that which could be converted to cash (Choong, D., 2001). Examples are cash, securities, accounts receivable, inventory, office equipment, real estate, a car, and other property. On a balance sheet, assets are equal to the sum of liabilities, common stock, preferred stock, and retained earnings. From an accounting perspective, assets are divided into the following categories: current assets (cash and other liquid items), long-term assets (real estate, plant, equipment), prepaid and deferred assets (expenditures for future costs such as insurance, rent, interest), and intangible assets (trademarks, patents, copyrights, goodwill) (Choong, D., 2001).

This is because the Islamic equity investment fund is based on, among other consideration, the Shariah maxim that a rule is based on the majority not the minority (*li al-kathir hukm al-kull*). Since the bulk, i.e. two-thirds, of the sources of funds for the company is from permissible sources, the minority source should be ignored and hence should not be of any consequence for purification.

There are, however, those who believe that the above-mentioned maxim applies only to the permissibility of investing in the company, and that the composition of the liabilities and capital side of the balance sheet should be considered with respect to purification. In this case, purification would require that we assign a portion of the income of the company to the debt source of funds and dispose of it (El-Gari, 2002).

APPLICATION OF PURIFICATION IN ISLAMIC UNIT TRUST FUNDS

In the process of purification of Islamic unit trust funds, two major approaches have been identified in the industrial practices. The first approach is that the investor himself is responsible for the purification process. The second approach is that the manager or the management company is responsible for the process.

The First Approach

In this approach, it is the investor who is responsible for the process of purification of their investment returns by means of zakat and charity. Investors in most Islamic unit trust funds of this approach are advised, on a quarterly basis, of the percentage of their investment that needs to be disposed off to purify their returns. It is the duty of every investor to carry out the process personally.

This is the practice in some countries, including Malaysia, where the unit trust management company does not pay the zakat on behalf of Muslim individuals and Muslim legal entities who are investors of the fund. These investors are thus required to pay on their own behalf.

The Second Approach

In the second approach, the process of purification is entrusted to the fund manager. He is not only required to calculate but also to dispose of the amount gained from the impermissible activities of the invested companies.

This is the regulation in some countries like Singapore where the fund manager is responsible for taking out the tainted portion of the returns and giving it away to charity before an Islamic unit trust fund, as well as other Islamic equity funds, are made available to the public. That is if any part of the composition of the equity fund is found not to be in compliance with Shariah principles, where a share of the revenue is derived from any non-permissible activities (Saw, H.S. & Karyn W., 2008).

According to El-Gari, the first method is more practicable as since no deduction from the net asset value (NAV) of the portfolio is made, the fund appears more profitable. Furthermore, as a result of the more profitable investment, the fund attracts more both Muslim and non-Muslim investors to invest in the fund (El-Gari, 2002). This is an important aspect to ensure the marketability of an investment product, where investors, more often than not, are looking at the performance of the fund to secure their capital. While the purification of profit and property is an obligation to the Muslim investors, as confirmed by the texts of al-Quran and Sunnah, it does not apply to the non-Muslim as they are not bound by the Shariah rules. Therefore, the Muslim investor needs to personally deduct the amount from the profit gained and dispose of it as zakat or charity in order to purify the property.

On the other hand, some Shariah scholars think an equity fund will not be fully Islamic unless all the returns to investors are pure, in the sense that the portion of profit gained from the impermissible activities of the company is disposed of. Hence, the fund manager must ensure the deduction of such portions and disposes of it himself to the appropriate place as a charity.

Some scholars are of the view that the money itself is neither pure nor tainted. Such things can only take place in the *dhimmah*. If one earns an amount of non-permissible income, his earning will be purified if he disposes of an equal amount from other sources.

CONCLUSION

From the foregoing discussion, it can be concluded that the purification is one of the important things in Islamic unit trust funds investment activities. It is a well known fact that such exercise is applicable to the funds invested in a portfolio where major permissible activities of the companies are contaminated with a portion of the non-compliant Shariah's elements. It is somewhat unavoidable at the time being as the listed companies in the stock market are not entirely free from the non-permissible elements as discussed. Therefore, the process of purification is vital to investors, especially Muslim investors, to ensure that the returns of the investments are free from the non-permissible elements.

It is also noted that the purification process, by the means of zakat, is carried out differently between one country and another. Some countries such as Singapore regulates that the fund manager is responsible for the process. Therefore, the amounts are taken out before the returns are distributed among investors.

On the other hand, in some countries, like Malaysia, the purification of the returns is voluntarily done by investors themselves. However in doing so, the percentage of zakat paid by the investors is not known. Perhaps, research needs to be conducted to evaluate the percentage of zakat taken out from the returns of Islamic unit trust funds investment.

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