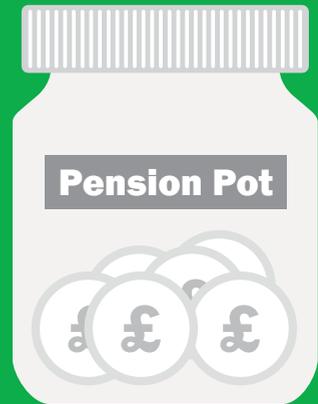




Zakat on Pensions



A step-by-step guide



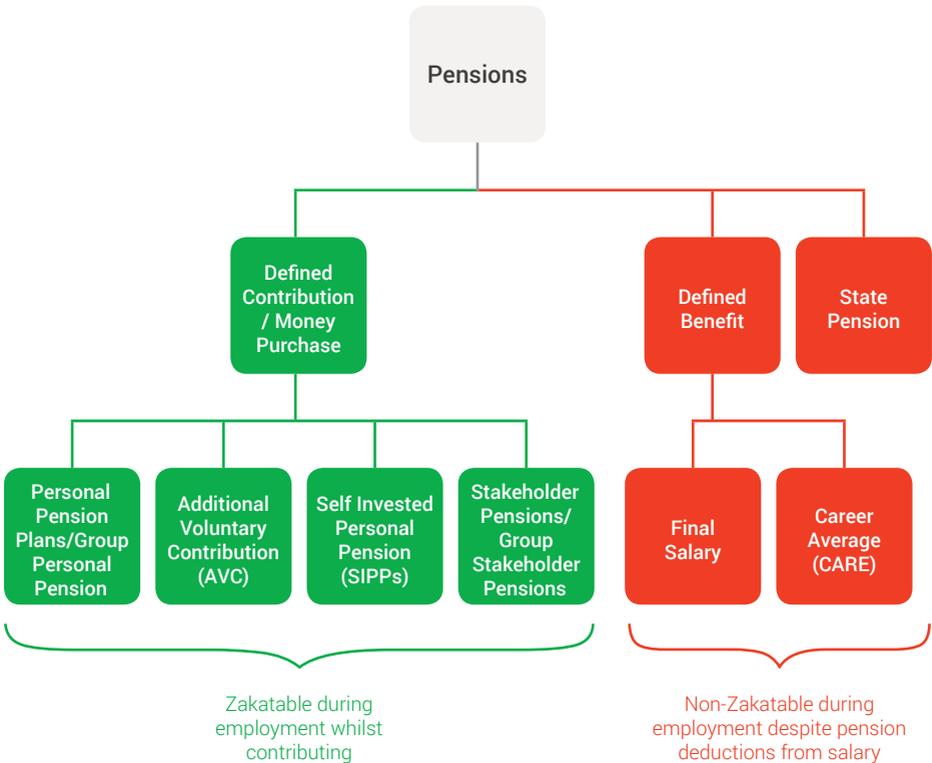
National Zakat
Foundation

Is your pension Zakatable?



Whilst contributing into a pension, not every type of pension is Zakatable.

The following 'green pensions' are Zakatable, whilst the 'red pensions' are non-Zakatable.



To determine the type of your pension, you may:

1. Check your pension statements
2. Call your pension provider
3. If it is a workplace pension, consult the HR department

Why are defined contribution schemes during the contribution period Zakatable?

1: Zakat is binding on all Zakatable assets in one's ownership

Ownership is a primary condition for Zakat obligation.

In a defined contribution scheme, the pension scheme member has ownership of the funds. The funds are registered in his name and specified for him. Another indication of ownership is the assumption of risk. The pension scheme member bears the risk of the performance of a defined contribution scheme.

2: Zakat is payable on productive wealth

Zakat is binding on wealth which is productive according to all four schools of jurisprudence.

Productivity in terms of Zakat refers to the potential of an asset to grow and increase. Productivity of an asset can be intrinsic as is the case with gold, silver and cash. Productivity can also be realised by trading and investing into Zakatable assets. And finally, productivity can be established through the breeding of flock.

Besides these three causes, the Sharia has not recognised any other cause of productivity. Personal assets and belongings which may appreciate will not be Zakatable despite growing in value as they are not productive wealth in Zakat terms. Considering pension contributions, they are invested into Zakatable assets for capital appreciation, growth and increase. Therefore, the Zakatable assets in the pension fund are productive wealth and Zakatable.

3: Access is determined by the ability to effect an increase and invest

If one can do this without having current physical access to money, then the money is Zakatable.

For the purpose of Zakat, access to the pension fund is only required to be able to effect an increase by way of investment. However, as the funds are already invested, physical access to the pension fund and the ability to withdraw at present are no longer required. Considering this, it becomes clear why Zakat is due on an investment in a fixed deposit Islamic account where physical access is restricted. In contrast, money deposited as collateral is not Zakatable as it is not invested on one's behalf and nor can they effect an increase as there is no access to it.

4: Access and control of the pension fund is realised through the fund manager

The Sharia principles of Wakalah (agency) confirm that access has been established to the pension fund for the scheme member via his fund manager.

A member has the discretion to select a fund manager of his choice to represent him and manage the investment on his behalf. The delegated fund manager has access and control of the assets in the pension fund. In this case, one has effectively allowed/volunteered to cede control to a fund manager with the express motivation of growing a portfolio on behalf of oneself. So, there is clearly wealth that is subject to growth and it is a pot of specific investments with a definable value, held in the individual's name.

5: Pensions are another type of investment albeit with a longer investment term

Zakat is binding on the underlying Zakatable assets in investments such as shares, equity funds, unit trusts and savings accounts with fixed-term deposits regardless of the term of investment.

Pension is just another type of investment albeit with a longer term than most investments. Generally, a pension cannot be unlocked prematurely. This does not mean a person does not have to pay Zakat; the inability to withdraw funds earlier than the date of maturity does not impact the ruling of Zakat. The nature of the pension plan is a long-term investment where the maturity date is upon retirement. Hence, it has the same rulings as any other form of investment. Thus, just as other investments which are locked for a term are Zakatable, pensions, which are locked for a longer term in favour of the pensioner, are Zakatable.

6: Zakat is binding on salaries which have been possessed directly or indirectly

Pension contributions are part of one's salary.

Zakat principles state that Zakat is not binding on outstanding salaries, however, Zakat is binding on salaries which have been possessed. A pension member takes possession of the contributions indirectly through the fund manager he delegates to manage the pension fund.

Why are defined benefit schemes not Zakatable during the contribution phase?

1. The accumulated assets in the pension fund are not owned by the employee

The employee owns the rights to receive a pension, but not the assets being accumulated to pay those pension obligations.

A defined benefit pension is typically run, on behalf of the employer by the Board of Trustees, who are responsible for all aspects of the scheme. Thus, the fundamental condition of ownership is not found. Therefore, the employee is not responsible to pay Zakat on the pension fund as he does not own the contributions.

2. The employer bears the performance risk of a defined benefit scheme

In a defined benefit scheme, the investment and performance risk of the fund is borne by the employer.

The employee, on the other hand, is entitled to a secure income after retirement by virtue of membership to a defined benefit scheme. Therefore, Zakat is not binding on the employee as he does not bear performance risk of the fund.

3. Salary deductions are not possessed by the employee

In a defined benefit scheme, salary deductions are never possessed by the employee.

The salary is deducted from his wages prior to possession. The salary remains a deferred salary owed to him. Zakat is not binding on unpossessed deferred salaries.

4. The scheme administrator is not an agent of the employee and nor is he delegated by the employee

In a defined benefit scheme, the employee does not delegate or select the scheme administrator.

Instead, the scheme administrator acts on behalf of the Board of Trustees to manage the defined benefit scheme without any form of delegation or Wakalah (agency) from the employee. Therefore, possession and access are never realised for the employee. As a consequence, Zakat does not become obligatory on the employee.

Understanding your pension fund for Zakat

A pension fund generally invests in a range of assets. Some assets in the pension fund are Zakatable whilst others are not Zakatable. Therefore, before you can calculate your Zakat, you need to know which assets are Zakatable.

Please note, some of the assets below are not Sharia compliant, however, Zakat is still due on the capital invested in that asset.

Assets in a Pension	Treatment for Zakat
Equities Listed Equities, Private Equity	40% of equities are Zakatable. These are shares in companies of a sector.
Fixed Interest/Income Bonds, High Yield Credits, Structured Finance, Gilts, Money Market	Despite the unlawful nature of the investment, the invested capital is 100% Zakatable whilst returns are unlawful and must be dispensed in charity.
Precious Metals Only gold and silver	Gold and silver assets are Zakatable at 100% of their value.
Cash and Equivalents Cash, Currencies	Cash assets are Zakatable at 100%.
Alternatives	Alternatives incorporate a range of non-traditional assets. This is usually a relatively small percentage and due to the high possibility of alternatives including Zakatable assets, one should add 100% of this as a precaution.
Commodities	Commodities are Zakatable at 100%.
Hedge Funds	Despite the unlawful nature of hedge funds, the invested capital is 100% Zakatable whilst returns are unlawful and must be dispensed in charity.
Other (unless identified as property)	The 'Other' asset incorporates several asset classes, many of which are Zakatable by default. Therefore, as a precaution, this should be treated as Zakatable at 100%.
Property and Real Estate	Property owned by a fund for rental income is not Zakatable. Note: shares in property development or real estate development companies are equities and are treated as equities.

Calculating Zakat on your pension



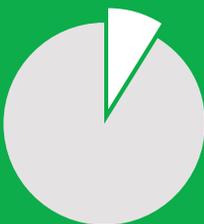
Step 1: Identify the asset class information of your pension fund

This can be done by one of the following ways:

- Look at the asset allocation on the Pension Factsheet in your statement.
- Search the name of your pension fund on www.trustnet.com to see the asset allocation and breakdown.

Step 2: Determine the total percentage of Zakatable assets in your pension fund

Add up the percentage of all Zakatable assets in the pension fund. For example, in the following asset allocation, only cash is Zakatable which is 8.70%.



Asset Allocation	
Cash	Property
8.70% of Fund	91.30% of Fund

Step 3: Apply the percentage on the total value of your pension fund

To determine the value of Zakatable assets, apply the percentage of Zakatable assets on your pension fund.

Considering the above example, only 8.7% of the fund is invested in Zakatable assets. If a person has a pension worth £10,000, he will only consider 8.7% for Zakat. Thus, £870 is the value of the Zakatable assets.

Step 4: Pay 2.5% Zakat on the figure determined from step 3

2.5% Zakat is due on the figure from step 3.

In the above example, £870 was the value of the Zakatable assets. 2.5% of £870 is £21.75. The Zakat due on this pension fund is £21.75.

If there is any difficulty in calculating or determining the Zakatable assets of your pension, you can call our Zakat experts on **03333 123 123**.

Equities Only Fund

If the portfolio consists only of equities, NZF advises to take 40% of the current market value of the portfolio as a proxy and then pay 2.5% of this figure.

This rule of thumb was extracted after NZF conducted extensive and rigorous analysis on the balance sheets of listed companies and compared their likely net Zakatable assets to their market values.

The following two case studies are more examples of how Zakat is calculated on a pension portfolio

Case study 1

In this case study, the pension fund is currently valued at £10,000. After considering the assets in the fund, 43% of the assets were Zakatable assets. Remember, the proxy of 40% is applied on equities. 43% of £10,000 is the Zakatable ratio.

Thus, the value of Zakatable assets in sterling is £4,300. £4,300 is Zakatable. 2.5% of £4,300 is £107.50. This person is responsible to pay £107.50 as Zakat on their pension.

Assets	Percentage of Assets in the Fund	Zakatable Assets' Percentage
Equities	70%	28% (40% of 70%)
Cash	5%	5%
Property	15%	0%
Other	10%	10%
Total Zakatable Assets' Percentage		43%

Current Pension Fund Value	£10,000
Zakatable Assets Value	£4,300 (43% of £10,000)
Zakat Payment at 2.5%	£107.5 (2.5% of £4,300)

Case study 2

In this case study, the pension fund is valued at £20,000 on the Zakat anniversary. After considering the assets in the fund, 51% of the assets were Zakatable assets. Remember, the proxy of 40% is applied on equities. 51% of £20,000 is the Zakatable amount.

Thus, the value of Zakatable assets in sterling is £10,200. £10,200 in the fund is Zakatable. 2.5% of £10,200 is £255. This person is responsible to pay £255 as Zakat on their pension.

Assets	Percentage of Assets in the Fund	Zakatable Assets' Percentage
Equities	40%	16% (40% of 40%)
Cash	5%	5%
Property	30%	0%
Other	10%	10%
Precious Metals (Gold)	10%	10%
Alternatives	10%	10%
Total Zakatable Assets' Percentage		51%

Current Pension Fund Value	£20,000
Zakatable Assets Value	£10,200 (51% of £20,000)
Zakat Payment at 2.5%	£255 (2.5% of £10,200)

Paying Zakat on pensions



Zakat on a pension fund is due immediately with the rest of one's Zakat. However, if the Zakat payment is relatively large, one may spread these payments out across the year and pay in advance of one's Zakat anniversary. On one's Zakat anniversary, a Zakat calculation must be made to ensure the total Zakat liability has been paid.



If paying in advance is not possible, as a last resort, one may spread out these payments across the year and pay in instalments in arrears, ensuring it is paid off before the next Zakat anniversary.

If the Zakat payment on the pension savings is beyond one's financial capacity and brings genuine difficulty to oneself, one should pay whatever amount they can at present. In addition, they should keep a record of what is outstanding and intend to pay it off in the future when finances permit.

Sharia compliance of your pension fund



The Qur'an and Sunnah command that one's investments are Sharia compliant. Many pension funds are invested in non-Sharia compliant assets and equities.

Profits from non-Sharia compliant investments are unlawful and must be dispensed in charity without any intention of reward. Therefore, if you have a non-Sharia compliant pension fund, we strongly encourage you to move your funds to a Sharia compliant portfolio and consider possible purification of your investments.

Zakat Calculation Essentials

Zakat is:

- A** When you take what you own
- B** Minus what you owe
- C** 2.5% of the total (if above the Nisab)

Zakat is calculated using a simple formula by subtracting deductible debts from your Zakatable assets. If the resulting figure is above a certain threshold (known as Nisab) then you must pay 2.5% of that figure as Zakat.

The Nisab is a figure based upon the value of a certain amount of gold or silver. As the price of these fluctuate, so does the Nisab value. We will help you to work this out later in the guide.

When referring to previous years, months or days in this guide, it will be based upon the Islamic (Hijri) Calendar. We will provide tools to help you work this out.

Part **A** — What you own

What you own is called Zakatable assets

Gold and Silver



Gold and silver - All forms of gold and silver, e.g. jewellery, coin, are subject to Zakat. The Hanafi school treats all gold and silver jewellery as Zakatable, regardless of whether it is worn or stored. The resale value will be used to determine its worth. Other schools of Islamic law do not consider personal worn gold and silver as Zakatable.

Cash & Receivables



Cash - All forms of cash, e.g. in a bank account, wallet, net rental income, or even under your mattress, are Zakatable.

Receivables - Cash which you have lent to others and debts owed to you from any business activity are also Zakatable.

Investments



Shares, Unit Trusts & Equity Investments - If shares are purchased with the main intention for resale, then the entire shareholding is Zakatable at the current market value. However, if shares are purchased as a long-term investment to generate dividends, then Zakat is only due on the net Zakatable assets of the company. This can be calculated from the company's annual balance sheet.

Pension - Defined contribution schemes are Zakatable whereas defined benefit schemes are not. For defined contribution schemes, Zakat is only due on the Zakatable assets in the pension fund. Zakat is calculated by determining the percentage of Zakatable assets in proportion to the pension pot value. Then, 2.5% of that net figure is the Zakat due on the pension. If the portfolio consists only of equities, NZF advises to take 40% of the current market value of the portfolio as a proxy and then pay 2.5% of this figure. Rental property in a pension fund is not Zakatable regardless of the percentage.

Business assets



Stock - Anything purchased with the intention to resell is Zakatable and is to be valued at its sale price for Zakat.

Part B — What you owe

What you owe is called deductible liabilities:

Personal liabilities



Debts that are due or outstanding for repayment on one's Zakat anniversary are deductible liabilities. Whereas debts in relation to future bills are not deductible, e.g. rent, utilities.

For long-term debt, e.g. mortgages, or student loans, the **non-interest** or capital amount can only be deducted for the forthcoming lunar year.

However, it is recommended that this deduction is only made if one fears the inability to repay the debt as a result of not making the deduction.

Part C — 2.5% Zakat on total (if above the Nisab)

Which leaves total Zakat



Take the total value of your Zakatable assets and subtract the total value of deductible liabilities. If the resulting figure equals or exceeds the Nisab (minimum threshold on that day), you must pay Zakat, which is 2.5% of this figure.

$$£ \text{ A } - £ \text{ B } > £ \text{ C }$$

Services of National Zakat Foundation

1: Query Service

Call: 03333 123 123

Monday - Sunday 10am - 9pm

Consult our Zakat specialists for any of your Zakat related queries.



Email: zakatquery@nzf.org.uk

Have your Zakat queries answered with competence by our Zakat consultants.



2: Workshops

Book a Zakat training session with our Zakat specialists.



3: Confidential Consultations

Book a confidential consultation with our Zakat specialists to assist you through your Zakat calculations.



Glossary

A

Additional Voluntary Contribution (AVC)

Contributions made by a member over and above his or her regular contributions.

Alternatives

The term “alternatives” covers a wide array of assets. These may be physical assets such as property or commodities (like gold, oil or corn); the term also refers to investment activities like hedge funds or private equity. It can even refer to investment in a geographic region like emerging markets.

Assets

An asset is an item of economic value that is expected to yield a benefit to the owning entity in future periods.

Asset allocation

The spread of fund investments among different investment forms.

B

Bonds

Loans to companies or governments.

C

Cash

Cash investments include money in bank deposits or in short-term money market securities.

Career Average (CARE)

CARE schemes are another kind of defined benefit scheme. Your pension is based on your average salary during the time you are in the scheme rather than your final salary at retirement.

Commercial property

Includes offices, industrial and retail premises.

Commodities

A commodity is food, metal, or another fixed physical substance that investors buy or sell, usually via futures contracts.

Contributions

This is the money paid into a pension fund for a member. It can be paid by a member or an employer. Contributions are sometimes called pension premiums.

D

Defined Benefit Scheme

A scheme where the scheme rules define the benefits independently of the contributions payable, and benefits are not directly related to the investments of the scheme. The scheme may be funded or unfunded.

Defined Contribution Scheme

This is where the size of the member's pension is not decided by the rules of the scheme. The size of the member's pension will be affected by how much money is put into the pension fund for the member, how much the pension fund has grown.

E

Equities

Investment in company shares.

F

Final Salary

Final salary schemes are a kind of defined benefit scheme. They pay you a pension based on your salary in the last few years before you retire (your final salary) and the number of years you've been in the scheme (your pensionable service).

Fixed Income

Fixed income securities, also known as bonds, are loans, usually taken out by a government or company which normally pay a fixed rate of interest over a given time, at the end of which the loan is repaid.

Fund Manager

The person or body to which the investment and management of all or part of the scheme assets are delegated to.

Fund Member

An individual who is either an active (working or contributing, and hence actively accumulating assets) or passive (retired, and hence receiving benefits), or deferred (holding deferred benefits) participant in a pension plan.

G

Gilts

Gilts are bonds issued by the Government to raise money.

H

Hedge Funds

A hedge fund pools the money of contributing investors and attempts to achieve above-market returns through a wide variety of investment strategies such as leverage, short sales and derivatives.

L

Listed Equities

Equities traded publicly in the listed companies on the stock market.

Listed Property

Listed property allows investors to purchase interests in a diversified and professionally managed portfolio of real estate across the commercial, industrial and retail sectors.

M

Money Market

The trade in short-term loans between banks and other financial institutions.

O

Other

Incorporates a range of assets such as could be derivatives, commodities, private equity investments, agribusiness.

P

Pension

A pension scheme is a type of savings plan to help you save money for later life

Pension Factsheet

A document giving information on the underlying fund.

Pension Statement

A pension statement shows how much is in your pot and usually an estimate of how much you might get when you start receiving pension.

Personal Pension

A personal pension is a type of defined contribution pension. The employee chooses the provider and makes arrangements for the contributions to be paid.

Private Equities

The private equity portfolio comprises investments in unlisted companies.

S

Self-Invested Personal Pension (SIPPs)

A self-invested personal pension (SIPP) is a pension 'wrapper' that holds investments until you retire and start to draw a retirement income. It is a type of personal pension and works in a similar way to a standard personal pension.

Stakeholder Pension

Stakeholder pensions are contract-based schemes. Contract-based schemes are provided by insurance companies and other pension providers. They're effectively a contract between an employee and the pension provider.

State Pension

The State Pension is a regular income paid by the UK Government to people who have reached State Pension age. To get it, one must have paid or been credited with National Insurance contributions.



Structured Finance

The essence of structured finance activities is the pooling of economic assets (e.g. loans, bonds, mortgages) and subsequent issuance of a prioritised capital structure of claims, known as tranches, against these collateral pools.

Unlisted Property

Unlisted property typically comprises investments in high-quality, professionally managed retail, office or industrial real estate with a focus on producing returns from both rental income and capital growth.

Note:

The research and recommendations in this guide represent the view of National Zakat Foundation after broad consultation with a number of scholars and pension specialists. It is acknowledged that scholarly views do differ on the matter of Zakat on pensions, and so readers are at liberty to consult and follow the opinions of reputable scholars in whom they trust. We also welcome critical and constructive feedback in order to continue improving our services for Zakat payers in the future.

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