Limited Liability of Shareholders: Islamic Perspective (A Critical Appraisal)

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Abstract

Risk sharing is the backbone of Islamic Financial Industry. No one is absolved of so long as he has some assets to discharge his financial liability. Hence, the issue of limited liability for the members of the corporation is of great importance. There are contradictory opinions about the permissibility of the limited liability. Some scholars are in its favor while some other consider it against the principles of Islamic commercial law. The concept of limited liability affects the rights of creditors i.e. if a company becomes insolvent and its entire assets are not sufficient to pay the debt, then creditors definitely lose their credit. Furthermore, limited liability creates space to absolve the debt from shareholders. In Islamic law, there is no space for absolution of debt. Hence, the concept of limited liability is not compatible with the principles of Islamic law.

Keywords: juristic personality; limited liability; Islamic Law.

Introduction

Limited liability means "shareholders are immune from personal liability for corporate debts and torts beyond the amount of their agreed investments in the corporation's stock." (Kahan, 2009) In other words, if a company with limited liability is sued, then the plaintiffs are suing the company, not its owners or investors. A shareholder in a limited company is not personally liable for any of the debts of the company other than for the value of his investment in that company.

The issue of limited liability for the members of the corporation is of great importance from a point of view of Islamic law. There are controversial opinions about the issue of limited liability from different Islamic jurists. Some jurists give arguments in its favor and some other deny this concept and declare it against the directives of Shari'ah. This matter is still suffering uncertainty, and is causing the inconvenience for the proper functioning of the financial matters of corporations in Islamic context. This problem needs to be

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addressed to determine the doctrine of limited liability of shareholders for the proper development and functioning of the Islamic financial business industry.

As there is no room for the absolution of the debt form Islamic viewpoint. Therefore, to pay back the debt is of great importance in Islamic law. The person incurring the debt has to return it in his earliest possible opportunity. If he dies without paying off the debt in his life, then it is the responsibility of heirs of the deceased to pay off his debt from the assets he left. Even if the deceased does not leave assets to pay off the debt or his assets are not sufficient to pay off the entire debt, then he has to pay it in the world hereafter.

Limited liability, in case the company becomes insolvent, leads to absolution of the debt which is injurious for the creditors. This wants to analyze the concept of limited liability in order to determine its validity under the principles of Islamic commercial law for which this study has been designed. This research study focuses to explore that whether the concept of limited liability, which emanates from juridical personality, is acceptable in Islam. It also explores that, if there is any space for the validity of limited liability, then on what basis and on what principles it may be the acceptable in Islamic financial corporate business transactions? For such investigation and appraisal, the attempt is made to find out and evaluate the opinions of the numbers of jurists on the principles of Islamic law.

Literature Review

Mufti Taqi Usmani (Usmani, 2004), S. M. Hasanuzman (Hasanuzman, 1989), Abdul Aziz Al-khuyyat (Al-khuyyat, 1994), Malik Hafeez (Hafeez, 2013) are the jurists favoring the principle of Limited Liability in corporations. They have put mainly two arguments for justification of the concept of Limited Liability. In their view, by giving the arguments in favor of limited liability, a slave who is authorized by his master to run the business, can take debts in course of business and these debts would be paid from the cash in his hand. In case the cash is less than the debts, he would be sold to adjust the remaining debts and his master would not be approached by the creditors to set off the debts. In other words, the liability of master is limited to capital given to the slave. Thus, in case the slave dies or becomes insolvent, the creditors cannot demand their claims from the assets of the master.

This is how the features of licensed slave are similar to features of the company of limited liability. In former case the slave is authorized by the master to run business and in later case the company is authorized by shareholders to run the business. On this analogy, the liability of shareholder is limited to their invested income and it would not go beyond their personal assets same as the liability of master is limited to assets given to the slave and it would not go beyond his personal assets. Therefore, the creditors of company cannot demand their claims from the shareholders of company if the company incurs the loss or becomes insolvent same as the creditors of slave cannot demand their claims from the master if the slave incurs the loss or become insolvent.

The contention that the liability of master is limited to the assets given to the slave for trade is generally found in classical *fiqh.* (Al-Sarakhsi, 1993), (Almawardi, 1999).

Supporters of limited liability also argue that, in modern corporate entities, a company is being treated as juristic personality. It has the functions of natural person. It may sell, purchase, rent, and hold the property. It can sue and it can be sued. In Islamic Jurisprudence, in their view, there are some precedents from which the concept of juridical person can be inferred.

1) Waqf is an example of juristic personality. The institution of *waqf* can sell, purchase and own the property from its own name. It can become the debtor and creditors. Although the *waqf* is not person, but jurists treat it as a person due to the attributes attached to it i.e. selling, purchasing and having the status of owner, creditor and debtor. (Usmani, 2004).

2) Bayt-al-mal that enjoys rights and shoulders obligations. The *bayt-ul-mal* from early days of Islam, accumulate the *Zakat, Khiraj, Jizyah, Khums*. It also used to collect the inheritance of heirless deceased (Al-Sarakhsi, 1993) (Usmani, 2004). Wages of judges and workers were paid from *bayt-ul-mal*. (Yousuf, 1885). This is how the *bayt-ul-mal* was considered as a juridical person.

Islamic law does not recognize the concept of limited liability. This view is expressed by famous contemporary scholar Prof. *Nyazee*, he explains that Shari'ah establishes the doctrine of liability by general principles al-*kharaj bi-al-daman* (Nyazee, 1998). He further explains that, "This principle maintains that a person is entitled to a profit on his investment to the extent that he is liable for the loss or liability arising from the business venture. If his liability is limited to a certain extent, then, his profits should be limited

proportionately. The investor will not be entitled to the profits that may arise from the credit or debt for whose repayment he is not liable. It is for this reason that the liability of an investor is always unlimited for all lawful business transactions*"* (Nyazee, 1998).

He also gives arguments about the unlimited liability of investors in Islamic business organization. He says, that "In all forms of business organization in Islamic law, the liability of an investor is unlimited. This was seen for all types of '*inan* and *mufawadah* contracts" (Nyazee, 1998). He also describes the two type of liability namely, joint and joint-cum-several. In joint liability, all the partners jointly answerable to pay the debts of the business, while in several liabilities each partner answerable to pay the debt individually and he can be sued independently for entire debt. After paying the debt he can claim it from other partners. (Nyazee, 1998)

While discussing about the conditions of limited *dhimmah* (liability) to juristic personality, he says that the human intellect must be attached to that very juristic personality. (Nyazee, 1998, p. 108)

Mujlisul Ulama have analyzed the arguments of the supporters of the limited liability. They have negated the concept of limited liability and quoted certain references to justify the negation (Ulama, 2000). They did not identify that what may be the acceptable standard of limited liability.

Research Methodology

This study is doctrinal based research focusing the relevant literature either directly or indirectly concerned with the research topic. It engages the investigative deliberation of both types of sources, namely primary and secondary. Such method dwells upon the explanatory study with an analysis of the relevant studies. For this purpose, relevant primary sources like Quran, Sunnah, *Ijma* (mutual consensus of jurists) Qias (analogy), classical *fiqh* literature and secondary source like research thesis and books articles are appraised.

The study of shareholders' liability related different views raises a critical appraisal of prevalent concept of liabilities in Islamic perspective. This study attempts to identify the differences as well as matching views of different scholars on concerning the research topic, and finally our own views for reaching any decisive viewpoint. Such pattern of research study will escort us to grasp the problems, resulting from prevalent variant opinions on the matter in question,

affecting the commercial transaction in Islamic corporate business.

Analysis and Discussion

The analogy of Limited liability with licensed slave as developed by the supporters of limited liability cannot be upheld for a number of reasons.

Firstly, the slave is human who acts with his intention. On the other hand, the company is fictitious person. Thus, the analogy of fictitious person with the real person is a false analogy.

Secondly, the liability of the master is only limited when the master restricts the slave to the paid capital. However, if he authorized him to exceed debt from the paid capital, then the master is responsible for all the debts incurred by the slave. On the other hand, the liability of company's shareholders limited in all cases, whether the company restricts the debt to the paid capital or oversteps it. Hence, the analogy of the limited liability of shareholders to licensed slave is false analogy.

Thirdly, in case the company incurs loss or become insolvent, then there in no way for the creditors to recover their debt. On the other hand, in case the slave incurs the loss or become insolvent, the creditors can still pursue the slave to take back their paid capital after his emancipation.

The contention that the slave can be pursued after his emancipation have been endorsed by the classical jurists. *Imam Kasani* said in this regard that the master would not be demanded to pay the due debt because there is no debt on master. It is the slave who will be pursued after emancipation (Al-kasani, 1986).

The same contention is adopted by *Ibn Modoud al Mosali* that the slave is liable for the debts incurred by him in course of business and he would be sold to pay this debt except that it is paid by the master. So, if the slave does not pay rather the master pays it, then the right of the creditors comes to end, and the amount, obtained from sold slave, will be distributed among the creditors according to their shares. However, in case the amount of sold slave is not enough to pay the debt, he would be demanded of remaining debt after his emancipation. (AL-Mosli, 1937).

The precedents *waqf* and *bayt-ul-mal*, as described by the supporters of limited liability to validate it, are also not sustainable to due to certain reasons:

Firstly, the purpose of *waqf* and *bayt-ul-mal*is not to earn profit, rather they are created for the welfare of human being. On the other hand, the company is a profitable institution whose purpose is to earn the profit. Therefore, the analogy of *waqf* and *bayt-ul- mal* with company having limited liability is false analogy.

Secondly, *waqf* has no *dimmah* (liability). *Ibn e Abidin* said in this regard that as for as *waqf* is concerned, it has no *dhimmah*. However, although the *fuqara* (the poor) do have *dhimmah*, but they are not claimed due to their large numbers. That is why, the debt is only established on caretaker of *waqf* ('Abidin, 1992).

Thirdly, if the caretaker of *waqf* and *bayt-ul-mal* does not expend the funds where they are required to be expended or he utilizes them for his personal benefits, then the *waqf* or *bayt ul-mal* cannot be sued, rather it is caretaker or ruler who is to be sued. Thus, the victim files a suit against the care taker or ruler not against the *waqf* or *bayt ul-mal*. on the contrary, company having limited liability can sue and it can be sued. (Ulama, 2000)

The Islamic legal maxim as quoted by Nyazee, "*al-kharaj bi-al-daman*".is much relevant to negate the concept of limited liability. The said maxims states that the entitlement of profit depends on bearing of the loss. Thus, the shareholders do not entitle the profit for which he does not bear the loss. Contrary to this, in limited liability, the liability of shareholders is limited to the extent of their invested capital while they benefit from all the profits, whether the profit arises from their capital or from debt for which he is not liable. This is violation of the well-established said maxim.

It is inferred form the Nyazee viewpoint (Nyazee, 1998) that the contractual parties must clarify the type of their contractual relation. If the relationship of the contractual parties to each other is ambiguous and uncertain, e.g. it is not clear whether they are *kafeel*, *wakeel* or *ameen* to each other, then the nature of their liability could not be specified. Similarly, the principles of Islamic commercial law, with respect to the rights and obligations of contractual parties, may not be applied properly. Therefore, it is to be carefully regarded the relationship of the contractual parties, whatsoever the type of contract they enter into, e.g. *inan*, *mufawadah* or *mudaraba*. The purpose of such clarification is also to identify the liability of investor and shareholders, so that the interest of creditors could be procured and debts could be not absolved arbitrarily.

It is also pertinent to note that the conditions mentioned by Prof Nyazee is worthwhile for the rulers to assign the limited *dhimmah* to juristic personality.

Limited liability untenable in Islam

The concept of limited liability (in its existing form) is not acceptable as it is against the principles of Islamic commercial law because in limited liability the liability is limited to the assets of the company and not to the assets of individuals. Hence, by liquidation of the limited companies, the burden of the loss is borne by the public exchequer or the public directly when the loans against the companies remained unpaid. The Holy Quran express that "Nobody will bear the burden of the other" (Al-Quran)..

Limited liability causes harm to the creditors. In this context, the saying of the Holy Prophet (PBUH) is worth mentioning that "Neither getting harmed nor harming others is allowed in Islam". (Anas, 2004).

The loans of the public are protected in Islam which is evident from many saying of the Holy Prophet (*SAW*) supported unlimited liability in the business and loan and directed to sell all the property of the insolvent except what remains for his basic necessities. It is reported by Abu *Saeed* that a person in the period of Holy Prophet got a loss in his purchased fruit and his debts were increased. The Prophet (PBUH) said, give him *Sadaqah*. Consequently, the people gave him *Sadaqah* but it did not exhaust all of his debts. Then the Prophet (PBUH) said, take whatsoever you find, nothing else. (At-Tirmidhi, 1975).

To accept the concept of limited liability is to accept the concept of absolution from debt which is against the injunctions of Islam. Islamic law does not allow to absolve the debt of insolvent. Here two traditions of the Holy Prophet are produced to understand this concept. First tradition is reported by *Salmah bin Alakwa* that the prophet (PBUH) did not offer the prayer of person who died without paying the debt due on him (Al-Bukhari, 2001).

A famous jurist *Muhibuulah Al-bihari* said that the death does not discharge the debtor from debt. Therefore, the jurist unanimously held that the debt will be demanded from him in the day of Judgment. (Al-bihari, 1908).

Another tradition of Prophet (PBUH), in this regard, states that the greatest (worst) of sins after the major sins prohibited by Allah is that a person dies with a debt and does not leave assets to pay it (Dā'ūd, 2009)

The liability of *Shaheed* (Martyr) with respect to debt is also not forgiven. The prophet (*SAW*) said in this regard that all sins are forgiven except *dain* (debt) (Hanbal, 2001)

Conclusion and Suggestions

The study as made above leads us to the conclusion, that the concept of limited liability of shareholders (in its existing form) is not acceptable as its base i.e., juristic personality has not been considered valid by Shari'ah. Some scholars have tried to justify the concept of limited liability on the basis of juristic personality but the arguments advanced by them to justify limited liability are weak and do not conform principles of Islamic law i.e. *al-kharaj bi-al-daman*. Hence, the liability of any person, firm or company should not be limited as it is the source of loss to the public. The government has the responsibility of protecting the goods and the property of people which is one of the five fundamental *masalih* or objectives of Shari'ah.

It is, therefore recommended that, the principle *al-kharaj bi-al-daman* shall be strictly applied while granting any entity the status of limited liability. Furthermore, the contractual relationship of the shareholders with each other must be clear, whether their relationship is on the base of contract of agency (الوكالة), guarantee (الكفالة), lease (الإجارة) or trust (الأمانة). So that, the provisions of Islamic law would be applied according to the that very nature of the contract.

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