The legitimacy of Limited Liability in Islam

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ABSTRACT

Proponents of Islamic Banking have claimed that the products offered by Islamic Banking Institutions are in harmony with Islamic principles and only the issues of legitimacy of Limited liability and Corporate Personality of Islamic Banks remain to be resolved under Islamic Law. Contemporary Muslim jurists have difference of opinion in these matters. It is of great interest for Islamic bankers that a fatwa in consensus be obtained so as to form *Ijma* in order to legitimize limited liability and associated corporate personality. Efforts are therefore underway, especially by scholars sitting on Shariah Boards of Islamic Banks to provide arguments in favor of limited liability. To support their viewpoint they have used the case of *Abd al mazoon* عبد المأذون or the authorized slave based upon *Hanafi* jurisprudence.

Objective: The purpose of this paper is to discuss the permissibility of the limited liability of business organizations especially Islamic Banks under Islamic Law using the case of Abd al mazoon.

Scope: We try to answer the question whether Abd al mazoon had limited liability or not in times when slavery was permitted?

Methodology: Literature review of various books of Islamic jurisprudence has been made. Books of Hanbali and Shafi fiqh have been used to give wider horizon to the discussion.

Findings: It was found that there was considerable disagreement in understanding of the liabilities of Abd al Mazoon. It seems that Abd al Mazoon enjoyed limited liability but his master was not responsible for business transactions and debts incur by this slave.

1. Introduction

Limited Liability means that the corporation's shareholders are not personally liable for its debts in the event of its winding up, and their liability only extends to the amount of capital they have put into their business. The concept of limited liability is considered back bone of the modern economy. It is argued that the existence of large corporations is due to this phenomenon. It is also alleged that the present economic malaise of the Muslim economies is due to lack of corporations and limited liability laws in Islam. (Kuran 2006)

The creation of Islamic Banks in Muslim countries has given impetus to the study and creation of Islamic ways of financing as Interest or *Riba* is prohibited for the Muslims. Islamic banks have come up with many innovative instruments of finance which are acceptable to Muslims. Shariah boards have been giving certificates of shariah compliance to these instruments. The modern Islamic banks have been modeled on the concept of limited- Liability Company. There is no precedence of this form of business organization in Muslim history as partnership was the most prevalent form of business in the past. At present, religious Muslims have debated whether limited liability breaks any Islamic laws or it can be adopted as general method of creating business organizations as laws in many Muslim countries prohibit creation of partnership of more than 20 members.

Efforts have been made by scholars sitting on the Shariah boards of the Islamic banks to prove that there is nothing wrong with limited liability concept and it should be considered as legitimate modus operandi for Islamic Banks as well as other businesses. However, this idea has been challenged by other scholars. Since this debate is taking place among scholars of *Deobandi-Hanafi* persuasion and they have not met agreement or reached a final verdict, in this paper we have widened the debate to include Shafi (Egypt, Indonesia, Malaysia etc.) and Hanbali (Saudi Arabia, UAE, Qatar, Kuwait etc.) schools. In matters of Islamic jurisprudence, rulings of both these schools are very similar.

The foundation for debate is the case of alleged limited liability of *Abd al mazoon*: a slave who has been given permission by his master to do business. This is a case described by Usmani (2007) as having closest resemblance to the concept of limited liability and hence he has tried to prove permissibility of limited liability on basis of this case.

Objective: The main aim of this paper is to discuss the permissibility of the limited liability of business organizations especially Islamic Banks as claimed by Usmani (2007) under Islamic Law using the case of Abd al mazoon.

Scope: We try to answer the question whether Abd al mazoon had limited liability or not in times when slavery was permitted?

Methodology: Literature review of various books of Islamic jurisprudence has been made. Books of Hanbali and Shafi fiqh have been consulted to give wider horizon to the discussion.

2. Liabilities in Islam

Classical Islam treats the liability of a free Muslim as unlimited. If a Muslim becomes so indebted that he cannot pay his debts from his belongings, the creditors are given right to take away all of his property except his house where he lives, his clothing including warm clothing, and other necessary items without which he cannot live.(Lahori, 2004)

Payment of the debt in full is considered important obligation in Islam. The Holy Prophet (PBUH) once refused to say *jinaza* prayers over a person who died in state of indebtedness until a companion undertook to pay debts of that person. (Shukani, 1250 H.) Furthermore, the heirs of the dead are also liable to pay debts of their relatives.

3. Abd al mazoon

According to various sources on Islamic jurisprudence, in old days when slavery was permitted, there was a class of slaves who were authorized to trade. They were called Abd al mazoon or "slaves authorized to trade". The master of the slave used to give to slave initial capital to do business (Usmani 2007). But the slave was free to enter into business transactions. The capital invested by the master belonged to the master.

Whatever the slave earned would also go to the master. According to Usmani (2007)

"If in course of trade, the slave incurred debts, the same would be set off by the cash and the stock present in the hands of the slave. But if the amount of such cash and stock would not be sufficient to set off the debts, the creditors had a right to sell the slave and settle their claims out of his price. However, if their claims would not be satisfied even after selling the slave, and the slave would die in that state of indebtedness, the creditors could not approach his master for the rest of their claims."

Usmani (2007) concludes that the master was actually owner of business; the slave was just an intermediary tool. *Liability of the master* was limited to the capital he invested including the value of slave. "*After the death of the slave*, the creditors could not have a claim over the personal assets of the master".

Rejoinder by Ulema

Usmani's efforts to prove permissibility of limited liability has met stiff resistance from scholars of Mujlisul Ulema of South Africa.

Scholars at Majlis Ulema South Africa (2007), say that actual trader, dealer, transactor and the contractor is Abd al mazoon, not the master. He has to pay his debts even if it takes his life time. If he is unable to pay his debts, whatever wealth and stock he has in his possession will be possessed by the creditors. After this, if the debts are not fully discharged, the creditors have two options:

a. To compel him to work and pay his debts
b. To sell him and take the proceeds of the sale as payment on his debt account

If after selling him, the debts are not fully paid, the creditors can still pursue him after he has been emancipated. The master cannot be held responsible for any debts incurred by the slave.

Majlis Ulema South Africa (2007), believe that the slave is working as an agent. And the slave run business is example of Principal (Muakkal) and an Agent (Wakeel). To them the Principal (in this case, the master) is not responsible for any debt incurred by the agent. So there is no limited liability for the slave.

The Shafi and Hanbali position

In the words of Imam Shafi , as reported by Muzani (d. 264 H.) ف العبد لا يملك شيئا *the slave does not own anything.* So whatever the slave possesses is the property of his master.

This is because the holy prophet has said: "*Whoever sells a slave who has property, the property will belong to the seller, except when the buyer stipulates the condition of acquiring it too."*

Moreover, when someone is selling an Abd al Mazoon, his capital may also be sold in a single transaction.

Regarding debt on slave run business, the position of Hanbali school is the same as Shafi school. According to these schools, the slave may be permitted to trade, but his earnings will be for the master. If there is any debt on slave run business, it will be paid from the capital in the hands of the slave. If anything from the debt still remains the slave will have to pay that too, if he is emancipated. There is no provision of selling the slave by creditors in Shafi or Hanbali law because the indebted slave is property of his master and it is impermissible for others to sell other people's property without authorization.

4. Roman slave-run company

What Usmani (2007) , Majlis Ulema South Africa (2007), Ibn Qudama (620 H.), and Shirazi (476 H.) have failed to mention is that the concept of Abd al Mazoon has been borrowed from the Roman law. Muslim jurists have just elaborated on this custom which was prevalent in the Arab society due to Roman influence. The Romans who employed slaves in business had these two components of business: a slave and a *peculium* (Abatino et.al. 2011). A peculium is the business inventory or money provided to the slave to do business and it formally remained property of the master. Because of limited liability of the slave which amounted to the size of the peculium, in the event of being indebted to greater amount than the peculium; the creditors could get hold of only what formed the peculium. The master could further reduce this liability by reducing the size of the peculium, and therefore the creditors of slave could suffer. The slave manager was not part of the peculium and could not be sold by the creditors. In the event of death of the slave or manumission of slave, the peculium was no longer there, as it was property of the master and could not be sold by the creditors.

It is evident that the Shafi and Hanbali views of Abd al Mazoon are quite consistent with the Roman law, and all of these provide for the *limited liability of the slave who is permitted to trade*. It may be noted that this limited liability is by-product, rather than an objective of the law which does not allow the slave to own things.

5. Conclusion

It can be concluded that the views of Hanbali and Shafi scholars at least prove that a slave had *limited liability* up-to the extent of capital he had at his disposal, *as long as he was a slave*. If this slave was later freed by his master, he would again be made liable to pay the full amount of debt to his creditors. Also, if this slave died as a slave, he would not be held responsible for his debts on the Day of Judgment. The law of limited liability in Islam therefore, seems to apply only to a person who *is* a slave.

This law does not apply to person who is a *free* person. Likewise, we think that this law should also not apply to a person who is an *artificial* person i.e. a company.

We suggest that further research be done to answer these questions: (1) Do Islamic laws apply to an artificial person in the same way as they apply to a natural person? and/or (2) is there a separate corporate entity in Islam? These questions have been deliberated upon by Usmani (2007), but after convincing himself of the legitimacy of corporate personality in Islamic law he concludes that limited liability is also permissible as a consequence of such decree. This is a farfetched conclusion in our view, as company law in Pakistan also allows a company to have unlimited liability.

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