

CHANGING PERSPECTIVES IN THE LAW AND PRACTICE OF TAXATION IN NIGERIA

ESSAYS IN HONOUR OF PROFESSOR M.T. ABDULRAZAQ



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CHAPTER TWENTY-FOUR

IS MUSHARAKAH (LIMITED PARTNERSHIP) TAXABLE UNDER THE NIGERIAN TAX LAW?

Olokooba Saka Muhammed*

1.0 INTRODUCTION

In the context of modern business, partnership is a way by which the capital base of the business can be boosted. In some instances, an investor may lack the required fund, such an investor ordinarily will apply to a financial institution to secure fund and a time the finance institution may release fund as a partner, thus such investment becomes joint ventures. Under Islamic finance, joint investment is allowed and same is ordinarily termed as *Musharakah* or *Shirkah*. *Musharakah* is a form of limited partnership¹⁴⁰⁰.

However, as observed by Taqi¹⁴⁰¹, even though *Musharakah* is a term frequently referred to in the context of Islamic modes of financing. The connotation of this term is a little limited than the term "*Shirkah*" more commonly used in the Islamic jurisprudence. For this *Musharakah* could be said to be a limited joint enterprises or partnership. There is no gainsaying in the fact that partnership or joint venture is permissible in Islam and therefore, taxing of such will also be a permissible act. The issue, however, is the appropriateness, convenience and or viability of using a conventional law to tax pure Islamic financial product.

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¹⁴⁰⁰ Abdulrazaq M.T 'Banking and Taxation in the name of God' cited in Olokooba S.M 'A Legal Analysis of the Taxation of Banking Business in Nigeria (1990-2010)', An unpublished Ph.D. Thesis, Faculty of Law, University of Ilorin, p.129

¹⁴⁰¹ Muhammed Taqi U. *An Introduction to Islamic Finance; Part One* (Ad-daawat ul-Islamiyah Book Centre), p.1

Structured into five sections, the concept of *Musharakah* is in section two of this paper. In section three, the paper discusses the profit and loss sharing principles in *Musharakah* while section four examines tax issues in *Musharakah*. Conclusion and recommendations is in the fifth section of the paper.

THE CONCEPT OF MUSHARAKAH EXAMINED

Musharakah in the conventional parlance simply means joint enterprises. *Musharakah* is defined in The Scientific and Practical Encyclopedia of Islamic Banks as, 'a partnership whereby the bank gives the partner the right to supersede it as owner in one or several stages according to agreement reached and to the way of operation, by setting aside regularly part of the yielded proceeds as installments to refund the share given by the bank'¹⁴⁰².

Musharakah is a financing technique in which the bank provides additional finance to an individual or company, which already has some funds for investment¹⁴⁰³. In any form of *Musharakah*, the business is on PLS, basis, and the pro-rata distribution of profit is stated in the contract and losses are shared according to capital contribution¹⁴⁰⁴. If it is in the Islamic finance institution, the bank may participate in the management in order to guide against any act that is *haram* (forbidden in Islam).

Musharakah as investment is a type where partners and or parties jointly participated in the running of a business. In such circumstances, the asset purchase with such fund is jointly owned by the parties and derivable profit is shared in agreed ratio. *Musharakah* under the Islamic finance principle may be in form of lease and or project financing. In this instance, the Islamic finance acquired beneficial interest and the customers always make payment to Islamic financial institution in the aggregate of the amount released.

¹⁴⁰² *ibid*

¹⁴⁰³ Sulaiman A. K and Mukhtar N.G 'Modes of Financing Islamic Banking' in Sulaiman A.K *et al* Islamic Economics: A Book of Readings (The International Institute of Islamic Thought, Kano), p.140

¹⁴⁰⁴ *ibid*

Musharakah in Islamic *Fiqh* is known as *Shirkah al-Amanah*¹⁴⁰⁵. It is a partnership between two or more parties who trade with a joint capital. The profit is to be divided into a known and fixed percentage. *Fuqaha* agree on that type of partnership; though there is disagreement on some of its conditions, but not on its permissibility. Abu Dawud quoting Abu Hurayrah, according to As-Sadiq¹⁴⁰⁶ said that Prophet Muhammad related that Allah said:

‘I am the third in a partnership of the two, but if one betrays the other, I withdraw from the partnership.’

This Hadith shows that *Musharakah* is legitimate and permissible. By holding equity positions, universal banks can essentially get involved in the decision making and management of the firm¹⁴⁰⁷ which they are in joint partnership. *Musharakah* has some derivatives and it can be financially engineered. However, the assimilation of *Musharakah* into derivatives and financial engineering are contentious in the classical Islamic banking¹⁴⁰⁸.

3.0 PROFIT AND LOSS SHARING IN MUSHARAKAH

One key feature of *Musharakah* is that such joint effort is built on mutual trust and a delegation of power. It also has equitable contribution and participation as its watchword. This according to As-Sadiq¹⁴⁰⁹ is in line with the position of Imam Māliki and the Shafi'i schools that profit should be distributed in proportion to each partner's share in the capital because profit relates to the capital and should, therefore, revert to the capital's owner. The Hanafi and Hanbahi schools of thought deemed that profits are to be distributed according to the terms of the agreement whether by half or by a percentage. Specifically, Taqi¹⁴¹⁰ expatiating further stated;

¹⁴⁰⁵ As-Sadiq Al-Darir 'Types and Methods of Investment in Islamic Finance' in Ataul Huq Pramanik (ed.) *Islamic Banking How far have we gone?* (IIUM Press Malaysia, 2009), pp.152-153

¹⁴⁰⁶ *Ibid* at p.153

¹⁴⁰⁷ Adamu U, and Farida M.S 'Principles of Islamic Risk Management', in Shehu U.R.A et al, *Readings in Islamic Banking and Finance* (International Institute of Islamic Banking and Finance, Kano), p.93

¹⁴⁰⁸ For details argument on this see, Sulaiman A. K and Mukhtar N.G, *op.cit*, pp.140-141

¹⁴⁰⁹ As-Sadiq Al-Darir, *op.cit*, p.153

¹⁴¹⁰ Muhammed Taqi U, *op.cit*, pp.36-38

In the view of Imam Malik and Imam Shafi'i, it is necessary for the validity of *Musharakah* that each partner gets the profit exactly in the proportion of his investment. Therefore, if A has invested 40% of the total capital, he must get 40% of the profit. Any agreement to the contrary which makes him entitled to get more or less than 40% will render the *Musharakah* invalid in Shari'ah. On the contrary, the view of Imam Ahmad is that the ratio of profit may differ from the ratio of investment if it is agreed between the partners with their free consent. Therefore, it is permissible that a partner with 40% of investment gets 60% or 70% of the profit, while the other partner with 60% of investment gets only 40% or 30%.¹⁴¹¹

The third view is presented by Imam Abu Hanifah which can be taken as a via media between the two opinions mentioned above. He says that the ratio of profit may differ from the ratio of investment in normal conditions. However, if a partner has put an express condition in the agreement that he will never work for the *Musharakah* and will remain a sleeping partner throughout the term of *musharakah*, then his share of profit cannot be more than the ratio of his investment.¹⁴¹²

In the case of loss, all the Muslim jurists are unanimous on the point that each partner shall suffer the loss exactly according to the ratio of his investment. Therefore, if a partner has invested 40 % of the capital, he must suffer 40% of the

¹⁴¹¹ Ibn Qudamah Al-mughni. V. 5p. 140, Darul-kitab al-arabi, Beirut 1972

¹⁴¹² Al-kasani, Bada 'I' -us-sana'i' v. 6 pp 162, 163.

loss and any condition to the contrary shall render the contract invalid. There is a complete consensus of jurists on this principle.¹⁴¹³

However, on the ratio of the share of a partner in profit and loss, Imam Shafi'i was of the opinion that, both must conform to the ratio of his investment. But according to Imam Abu Hanifah and Imam Ahmad, the ratio of the profit may differ from the ratio of investment according to the agreement of the partners, but the loss must be divided between them exactly in accordance with the ratio of capital invested by each one of them¹⁴¹⁴. It is trite to note however, that before granting of any facilities, the banks or financial institutions will study the feasibility of the proposed business for which funds are needed. Not only that, there will always be a diversified portfolio of *Musharakah*¹⁴¹⁵.

4.0 TAX ISSUES IN MUSHARAKAH

Some notable issues that could surface while taxing *Musharakah* with the use of Nigerian conventional tax laws are as follows:

- a. Considering the wider connotation of 'conveyance on sale' as given in Stamp Duties Act¹⁴¹⁶, which includes,
 - (a) every instrument, and every degree or order of any court whereby any property or any estate or interest in any property, upon the sale thereof is transferred to or vested in a purchaser or any other person on his behalf or by his directions;...

The funding instrument and most especially the conveyance agreement of the subject matter of transaction between the Islamic financial Institution and the customer may attract Stamp Duties. However, on the other hand, if it were conventional financial Institutions, such loan will not attract Stamp Duties since it is a not a physical property.

¹⁴¹³ Ibn Qudamah, *Almughni* v. 5p. 147, see also Taqi, *op. cit*, p.37

¹⁴¹⁴ Taqi, *op. cit*, p.38

¹⁴¹⁵ Olokooba S.M, *op.cit*, p.129

¹⁴¹⁶ Section 52(1)(a)

- b. Since equitable right lies with the Islamic financial Institution in the fund provided, the excess fund received by the Institution is always liable to withholding tax. However if it were in conventional institution, since such will amount to interest, it will not be liable to withholding tax.
- c. The VAT issue in the Taxation of *Musharakah* may come up due to the performance status of the Islamic Financial Institution. For instance, if the Islamic Financial Institutions act as a Mortgage Institution, such beneficial interest purchased by the customer will be VAT exempted; but if it acts otherwise, VAT is chargeable.

5.0 CONCLUSION AND RECOMMENDATIONS

From the foregoing, it could be gleaned that, tax issue in *Musharakah* just like other Islamic finance transactions is not an outright easy bet. Therefore, to tax *Musharakah* with the use of Nigerian Tax Law may look ordinarily impossible due to some inconsistency in the transactional nature and features of Islamic finance as against the conventional Nigerian tax laws. However, the position of this paper is that this problem is surmountable by adhering to the following recommendations:

- There is the need for an application of a more shariah compliant tax interpretation coupled with some amendment of the current Nigerian tax laws that will make *Musharakah* taxable devoid of any infringement on Islamic finance principles.
- Specifically, section 52 (1)(a) of the Stamp Duties Act, should be amended. The precise amendment needed is the exemption of conveyance agreement of the subject matter of transaction between the Islamic bank customers and the Islamic Financial Institutions. This exemption will aid the operation of *Musharakah* as a mode Islamic finance. Therefore, the word '*save that of Islamic Financial Institutions and their customers*' should, therefore, be inserted after 'instrument' to read thus

every instrument '*save that of Islamic financial Institution and their customers*', and every degree or order of any court whereby any property or any estate or interest in any property, upon the sale thereof is transferred to or vested

in a purchaser or any other person on his behalf
or by his directions;...

- Finally, all the excesses earned by the Islamic Finance Institution either as mortgage or non-mortgage institution should be VAT exempted. The rationale behind this recommendation is to allow for the actualisation of *Musharakah* as a financial product.