ARTICLES OF FAITH

Diana Hamade and **Suzanne M Reisman** offer an international perspective on the culture and practice of Shari'a-compliant philanthropy

KEY POINTS

WHAT IS THE ISSUE?
Philanthropy is an integral part of Shari'a law, regardless of whether tax benefits are available to the donor.

WHAT DOES IT MEAN FOR ME?
Clients who have income/gains taxed in the UK, US or other jurisdictions may wish to create charities that qualify for tax relief in the relevant jurisdiction, while still being administered in accordance with Shari'a law.

WHAT CAN I TAKE AWAY?
This article provides a very broad overview of the intersection of Shari'a and tax-efficient donations to charities, using the US and UK as examples.

The definition of what is considered 'charitable' is similar in many jurisdictions, cultures and religions, although they are by no means uniform. This is particularly true when one compares what is an exempt or charitable object under common law in the UK or US, for example, against what is *zakat* and *sadaqah* in Shari'a law.

CHARITY AND ISLAM

ZAKAT AND SADAQAH

Zakat is the obligatory giving of charity, and a duty on every able Muslim. The principles of *zakat* require all Muslims who have wealth in excess of the threshold (*nisab*) during the prior lunar year to donate to charity. Broadly, the *nisab* is based on the value of 3oz of gold, or 21oz of silver, or its cash equivalent. The practice of *zakat* varies by country and among the various schools of Islam and is required by law in some Islamic countries,[1] but is voluntary in others.

Zakat focuses primarily on humanitarian relief and the relief of poverty. The Quran specifies the following categories of beneficiary: the poor, the needy and those in need of humanitarian relief; the *Amil* (those appointed to administer *zakat* funds); the *Muallafa* (those who have embraced Islam); the *Gharimin* (those in bondage and in debt); *Ibnussabil* (stranded travellers on a permissible journey); and the *Fisabilillah* (those striving for the betterment of the community, e.g. individuals involved in infrastructure projects, community development, youth engagement, education and cultural projects).

Broader than *zakat* is *sadaqah*, an act of worship by which charity is given voluntarily. *Sadaqah* may be donated for any noble cause that is consistent with Islamic principles. Neither *zakat* nor *sadaqah* promote or support anything that is *haram* (prohibited), such as pork, alcohol or *riba* (interest imposed on a debt). This should be borne in mind particularly when setting up microfinance projects, which must be structured so as not to fall foul of *riba*.

To ensure Shari'a compliance, such projects often make use of *sukuk*, or Islamic bonds, which are specially tailored for the purpose, and these are becoming increasingly sophisticated. In October 2018, the government of Indonesia launched a *waqf*-linked *sukuk* that will benefit social projects, while other similar Indonesia-based projects are being developed to offer a blockchain-based *sukuk* to fund microfinance projects.[2]

WAQF

A *waqf* is a perpetual entity frequently used in the Islamic world to create charitable endowments. A *waqf* may be structured so that it is classified as a charitable trust in the UK or US. As with common-law charitable trusts, there is a public benefit requirement and the operation of the *cy-près doctrine*, which allows assets to be distributed for other charitable purposes if circumstances alter.

Under Shari'a law, impoverished persons are regarded as the ultimate default beneficiaries of every *waqf*. Therefore, when all other purposes for which a *waqf* has been created fail, usufruct may be lawfully applied for the relief of poverty, although the relief of poverty is not expressly mentioned in it.

SHARI'A PHILANTHROPY ABROAD

THE US AND UK

Charities and foundations can be set up in line with Shari'a principles in non-Islamic countries, but careful attention must be paid when doing so. In the US, donations to charities are eligible for tax relief if the charity is organised and operated for 'exempt purposes'; this includes religious, charitable, scientific, literary or educational initiatives (such entities are commonly referred to as 501c3 organisations).[3]

Here, it is important to note a discrepancy between Shari'a and US law, in that donating to impoverished family members, or helping family members to eliminate debt, is one of the most virtuous forms of charity under Shari'a law; in the US, if an individual provides economic assistance to relatives or satisfies a relative's debts, these transfers are generally classified as gifts and are ineligible for US tax relief.

Organisations that are established to benefit private individuals (and that are not part of a charitable class) are only eligible for tax relief if they qualify as a split-interest vehicle (SIV), such as a charitable remainder trust, a charitable lead trust or a pooled income fund. As many *waqfs* are deemed to benefit private individuals, to qualify, they must be structured either as an SIV or only to benefit charities.

US tax law categorises charities as either public charities or private foundations. A charity is assumed to be a private foundation unless it can demonstrate that it is a public charity. The distinction is important, because it impacts both the extent of the regulation imposed (private foundations are subject to additional regulation, the violation of which may result in the imposition of excise taxes)[4] and the extent of the donor's tax relief.

Generally, public charities include mosques or other houses of worship, as well as various other institutions, such as hospitals and public museums.[5] Family foundations and entities such as *waqfs*, however, are typically characterised as private foundations because they have a single or limited source of contributions.

The availability of US tax relief depends on the donor's tax position, the type of property being donated, and whether the donor is seeking an income, gift or estate tax charitable deduction. US income tax relief is only available to charities that are created under the laws of the District of Columbia or a US state. Similarly, UK tax relief is available to charities that are created under UK law, as well as charities that meet its definition of a charity as created under the laws of EU Member States, Iceland, Liechtenstein or Norway.[6]

Gifts and bequests to foreign charities made by US citizens and domiciliaries may be eligible for the US federal gift and estate tax deduction if the foreign charity is equivalent to a US charity. Gifts to US charities that are used outside the US and to UK charities that are used outside the UK may qualify for a US income tax deduction or UK tax relief.

For example, if a donation is made to American Friends of the Louvre, a 501c3 organisation, the donation may qualify for US income tax relief even if the donation is then transferred to the Louvre in Abu Dhabi. It is also possible to obtain tax relief in the US and other jurisdictions, including the UK, by creating a 'dual-qualified charity'.[7]

Individuals who are classified as non-resident aliens for US tax purposes (because they are not US citizens and are not tax resident in the US) can deduct US income tax as against income that is 'effectively connected with a US trade or business'. This includes income earned in connection with many operating businesses organised as limited liability companies, certain rental income and gains from the sale of US real property and certain personal services income. This would exclude interest, dividends and other 'fixed annual, determinative or periodic income that is subject to withholding tax'. Accordingly, donors may make donations to US charities for purposes that are consistent with Shari'a and that also work to reduce their US tax liability.

CONCLUSION

Charity is an integral part of Islam. At its core, the concept of philanthropy is similar throughout the world, and there are more similarities than differences between the objects of *zakat* and charitable purposes under (for example) the laws of the US and the UK. While the decision to pay *zakat* or *sadaqah* is a personal one that is not tied explicitly to tax benefit, there remain many opportunities to make charitable donations that are Shari'a-complaint, cross-border and tax-efficient.

1 Such as Libya, Malaysia, Pakistan, Saudi Arabia and Sudan
2 www.reuters.com/article/islamic-finance-social-finance/islamic-bonds-look-to-tap-social-finance-blockchain-tools-idusl8n1x43bt
3 For more on the definition of US charitable organisations, see p.55.
4 ss.4940–4945, 4948 of the US *Internal Revenue Code of 1986*, as amended. In addition, private foundations may be subject to an annual excise tax of 1–2 per cent depending on its operations.
5 Other charities may qualify as public charities if they qualify as 'supporting organizations' based on their supportive relationships of one or more public charities.
6 www.gov.uk/charities-and-tax/get-recognition
7 Dual-qualified charities consist of two entities created in the US and another jurisdiction, and are outside the scope of this article.


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