

**DEVELOPING SHARIAH COMPLIANT CORPORATION:
AN APPRAISAL ON THE RIGHTS AND LIABILITIES OF MEMBERS UNDER
THE MALAYSIA LAW AND SHARIAH**

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ABSTRACT

Shareholders are members of a company through share capital ownership. They proclaim themselves as “owners” although they have no direct involvement in business management which is wholly vested in the board of directors. In Malaysia, shareholders merely receive bundles of right in the company as prescribed under the Companies Act 2016. Due to the separate legal existence of a company, they are not liable for the company’s debts and liabilities. Contrarily, under Shariah, *musharakah* is a partnership agreement between individual partners for participation in capital and profits. It essentially regards them as the joint owners of *musharakah*, treating their existence inseparable from this business entity. The partners collectively share mutual rights and duties in the *musharakah* business according to their contractual agreement which makes them jointly liable for any liabilities incurred by the *musharakah*. This article discusses the rights and liabilities of members of a company under Malaysia Law and Shariah. It highlights the substantial distinctions between the shareholders’ rights and liabilities under the Companies Act 2016 and those of partners under *musharakah*. This article argues that an inculcation of Shariah principles of *musharakah* into the current legal structure of corporation is needed so that the Shariah-compliant status is always maintained.

Keywords: Company, Malaysia, members’ rights and liabilities, *Musharakah*, rights and liabilities in *Musharakah*, separate legal entity.

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1.0 INTRODUCTION

A company is an artificial person. Upon its incorporation and compliance with certain procedures, it comes into existence and is a separate legal entity being distinct from its members and officers. This principle of separate legal entity was long established in the landmark case of *Salomon v Salomon & Co Ltd* (1897) (Meng, 2017). It is indeed a legal business vehicle which was historically originated from a partnership but later evolved into a legal species having its own features and attributes (Abbasi, 2009). Nonetheless, prior to its establishment, it must at first be incorporated by its members by way of registration.

In general, members of a company are persons whose names are registered in the memorandum of associations as the subscribers of the company's shares. They are often considered as the shareholders of the company and hence, they are "owners" of the company. They are given certain rights attached to their respective shares but they are not directly involved in the company's business management as it is duly delegated to the board of directors as an agent of the company (Rachagan, Pascoe, & Joshi, 2010). Due to this separation of ownership and management functions, they take less participation into the company's business and affairs and receive dividends declared by the board. They are simply not liable for the company's liabilities due to limited liability feature except for their unpaid capital amount owed to the company.

Distinguishably, *musharakah* (Islamic partnership) is defined as "a participation of two or more persons in a certain business with defined amounts of capital according to a contract for jointly carrying out a business and for sharing profit and loss in specified proportions" (Siddiqi, 1987, p. 15). It is a classical business organization practiced by the Muslim entrepreneurs in the Islamic civilization history (Timur, 2005). It carries numerous types of partnership including *mudharabah* and its establishment is founded on the basis of contractual agency relationship between the members. Their rights and liabilities are jointly and severally inseparable and mutually agreed in accordance with terms and conditions of the partnership agreement.

This paper aims to compare the rights and liabilities of members under the Companies Act 2016 and Shariah. This comparison is imperative since many discussions have attempted

to equate both business entities equally which may lead to confusing outcomes. It recommends an inculcation of Shariah principles of *musharakah* into the current legal structures of a corporation in ensuring that the Shariah-compliant status of corporation in Malaysia is always maintained, at least, from its incorporation level.

2.0 COMPANY UNDER COMMON LAW AND MALAYSIAN LAW

Company is a collection of individuals, a corporate body and a legal entity distinct from the members creating it upon its incorporation. Lord Coke, defined company as “a corporate body, because the persons comprising it are made into one body by the process of incorporation according to the law of the land” (Shukla, 1972, p. 195). By legal process, this corporation conceptualized from its literal understanding as the association of persons, is clothed with legal personality, as a right-and-duty bearing unit (Dewey, 1926).

The establishment of corporation law into corporate world history begins with the decision of House of Lords in *Salomon v A Salomon & Co Ltd* [1897] AC 22, HL. Playing a significant role in developing company law, the Salomon case introduces the principle of separate legal entity of a corporation distinct from its members (Abd Ghadas, 2007). Indeed, the corporation as a legal entity is treated under the law a “person” instead of an individual human being (Abd Ghadas & Abdul Aziz, 2017). In general, under common law, a company as a juridical or legal person or specifically a corporate personality is assigned with a few legal characteristics such as to own its assets and bear its liabilities, perpetual succession, having a full capacity to hold property under its name and common seal, having right to take legal proceeding and others (Murali & Arya, 2018).

The Malaysian company law statutorily adopts the common law of doctrine of corporate personality (Hassan, Abd Ghadas, & Abdul Rahman, 2012). Section 3 of the Companies Act 2016 (“the Act”) defines corporation as any corporates formed or incorporated or existing in or outside Malaysia and includes any foreign company, limited liability partnership and foreign limited partnership. Section 20(a) and (b) of the Act further states that a company incorporated under this Act is a body corporate and shall have legal personality separate from that of its members and continue in existence until it is removed from the register. Section 21 of the Act provides that a company shall have unlimited capacity to carry on or undertake any business or activity including to sue and be sued, to acquire, own, hold, develop or dispose of any property and to enter into transactions.

3.0 MEMBERSHIP OF CORPORATION IN MALAYSIAN COMPANY LAW

A member of a company is a person whose name appears in the company's register of members. Section 2(1) of the Act defines a member as follows: (a) in the case of a company limited by shares, a person whose name is entered in the register of members as the holder for the time being of one or more shares in the company or (b) in the case of a company limited by guarantee, a person whose name is entered in the register of members.

To become a member, Section 18(2) of the Act provides that a person shall become a member of a company upon its incorporation if he is named as a member in the application for incorporation of the company. Although this provision does not expressly state so, it does recognize other modes for entry into the company's register of members which are *inter alia* subscribing to the memorandum on the company's incorporation, successfully applying to a company for shares, purchasing shares from an existing member of a company and shares acquisition as a result of a member's death or bankruptcy (Meng, 2017).

As far as the relationship of members *inter se* is concerned, Section 33(1) and 38(6) of the Act stipulate that the constitution is a contract between the members of the company and shall be binding on them. This is proven in *Wong Kim Fatt v Leong & Co Sdn Bhd* (1976) where the court held that by virtue of one of the articles of the company, the minority shareholders must sell their shares to the majority shareholders as the said article contractually obligated them to do as such. Ironically, this contractual obligation does not constitute an agency contractual relationship among them themselves. In other words, neither of them are agent to another and they is agent to another and they are not agent to the company and vice versa (Rutledge, 2014).

4.0 MEMBERS' RIGHTS AND LIABILITIES IN THE COMPANY

Members of a company are privileged with certain legal rights and benefits in the company regardless of whether or not they have a direct participation in its business operations. All these privileges start from their purchase of shares or capital investment in the company (Mohd Sulaiman, Bidin, Hanrahan, Ramsey, & Satpledon, 2008). In the case of *Borland's Trustee v Steel Brothers & Co Ltd* [1901] 1 Ch 279, Farwell J defines share as "the interest of the shareholder in the company measured by a sum of money and made up of various rights contained in the contract" (Geoffrey, 2010, p. 42). The members upon subscribing the company's shares, are entitled to certain rights attached to their shares. In other word, once a member's name is registered in the company's register of members, he will enjoy the rights conferred by the Act on members. Among the statutory rights are as follows:

- i. Right to exercise the right to vote attached to the share (Sec. 90(2) and (3));
- ii. Right to receive notice of meetings of the members (Sec. 101(2)(b) and 321(1));
- iii. Right to question, discuss, comment and make recommendation on the management of the company (Sec. 195);
- iv. Right to receive dividends declared by the company (Sec. 101(2)(c));
- v. Right to appoint proxy to attend, participate, speak and vote at the members' meeting (Sec. 334);
- vi. Right to restrain the company from entering into a substantial value property transaction without their approval (Sec. 223 and 228);
- vii. Right to take action against the company or directors or other members for oppression (Sec. 346);
- viii. Right to take action in the name of the company (Sec. 347 and 348); and
- ix. Right to wind up the company (Sec. 464 and 465)

Source: Meng, 2017

The main purpose of the incorporation of company for members is to enjoy limited liability. The company alone incurs its own debts and liabilities and its creditors are restrained to pursue the members' personal assets in the event the company's assets are insufficient to meet the creditors' claims. This creates a 'veil' between the company and the members as a legal consequence of adoption of separate legal entity doctrine (Mohd Sulaiman et al., 2008). Thus, in the case of a limited liability company, the members are not liable for its debts and liabilities except for unpaid share capital owed to the company upon its liquidation. If they made a fully paid up shares, they are not liable to the company's debts at all since their liabilities are limited to their shares so subscribed. This is opposed to the unlimited liability company where they are liable for its liabilities irrespective of whether the shares are fully paid up or otherwise (Meng, 2017).

5.0 MUSHARAKAH AND MUDARABAH UNDER SHARIAH

The Islamic law acknowledges a wide form of business structures for multiple purposes such as commercial trading, investment, profit-driven and the like (Abd Ghadas & Engku Ali, 2011). One of the structures recognized is known as *sharikah/shirkah* or *musharakah*. Literally, *musharakah* denotes mingling or merging (*mukhalatah*). Jurists defined it as becoming merged (*ikhtilat*) which means "blending one of two properties (mal) with other in a way that the two cannot be differentiated one from the other" (Sadique, 2009, p. 4).

The definition of *musharakah* differs from one the Islamic school of thought (madhab) to another. As explained by Sadique (2009, pp. 5-7) Hanafi jurists define *musharakah* as “a contract between two partners in the capital (*asl*) as well as the profit (*ribh*)”. According to Maliki jurists, *musharakah* refers to “permission (granted) to each other to transact while retaining the right with each”. This is not the same with the Shafie jurists where they define it as “every right (*haq*) established between two or more (parties) in common (*a’la al-shuyu’*)”. *Shuyu’* connotes the indistinguishable nature of the portion between partners, which signifies their joint and common entitlement to a subject matter. According to Hanbali jurists, *musharakah* is defined as “joining together in entitlement (*istihqaq*) or (the right of) transaction (*tasarruf*)”.

The various definitions highlighted above refer to three aspects. Firstly, *musharakah* is essentially a contract between -at least- two or more parties. Secondly, it authorizes the partners to transact with the capital or partnership property. Thirdly, the element of profit-sharing as enunciated by the Hanafi jurists. All these three aspects are material for formulating elements (*arkan*) of a valid *musharakah* contract found in the scholars’ traditional *fiqh* literatures (Abd Ghadas & Engku Ali, 2011).

6.0 TYPES OF MUSHARAKAH/SHARIKAH

Musharakah or *sharikah* is generally divided into two categories namely; *sharikah al-milk* (co-ownership) and *sharikah al-a’qd* (contractual partnership). The origin of co-partnership is the joint ownership of property and its joint ownership is the only qualification and no joint exploitation of property is needed. It occurs when two or more people are partners in the possession of property (Abd Ghadas & Engku Ali, 2011). The governing rule of this co-partnership is that any increase in the property shall be shared by the co-owners in proportion to their ownership extension. In fact, it does not involve an agreement of agency between them, and a partner may transact only in his/her own share. He is indeed a stranger (*ajnabi*) to the shares of others (Sadique, 2009). They have no liability towards another, except for actions expressly authorized by any of the partners. Their partnership is only limited to ownership and any potential profit sharing or increase in the co-owned property, not to the liabilities arising from the partners’ respective actions (Abd Ghadas & Engku Ali, 2011).

Meanwhile, *sharikah al-a’qd* is a partnership that exists consequently upon a mutual contract between two or more parties. To formulate a valid partnership, acceptance through conduct is adequate. Through this contract, the partners become their respective agents, delegated to utilize the capital for the partnership’s business. The legal effect of this contract is

that they jointly own the subject matter of the contract, i.e. the partnership itself (Sadique, 2009). In addition, the focus of this partnership is on joint participation to both the capital, profits and losses, based on the terms of the partnership. Joint ownership is only constituted as the effect in this partnership and not as its precondition (Abd Ghadas & Engku Ali, 2011).

Sharikah al-aqd is further divided into three types, depending on types of capital; namely *sharikah al-amwal*, (monetary partnership), *sharikah al-abdan* (labour partnership) and *sharikah al-wujuh* (reputation partnership). *Sharikah al-amwal*, that is based upon monetary contribution is further divided into two categories; *sharikah al-inan* and *sharikah al-mufawadhah*. The former refers to a limited investment partnership by each partner who only transacts with the partnership capital to the extent of their joint capital, in accordance with the terms of the partnership agreement. The latter connotes unlimited investment partnership whereby each partner equally contributes and transacts to the partnership capital and property (Abd Ghadas & Engku Ali, 2011).

Another type of *musharakah* according to some classical Muslim jurists is *mudharabah*. It is a form of commercial arrangement where one of the contracting parties act as the provider of capital or investor (*rabbul-mal*) while the other party acts as the entrepreneur (*mudharib*). Al *mudharabah* is different with other forms of *musharakah* in a sense that one party provides capital while another party provides management skill in the *mudharabah* business. Unlike *mudharabah*, all partners contribute to both capital and management of the *musharakah* (Abd Ghadas & Engku Ali, 2011).

7.0 PARTNERS' RIGHTS AND LIABILITIES IN THE MUSHARAKAH

Hasanuzzaman (1996) articulates that some rules governing the conduct of the business in *musharakah* are based on the customary commercial practices ('*urf tijari*'), or other secondary sources of Shariah. These rules may include the partners' rights in the *musharakah*. For Siddiqi (1987), their rights are subjected to the limits of freedom of transactions accorded to the partners which are listed out below:

- i. Right to enter into *musharakah* or *mudharabah* on behalf of a joint enterprise;
- ii. Right to enter into *musharakah* with a new party in a private capacity;
- iii. Right to supply joint capital to a third party on the principle of *musharakah*;
- iv. Right to give joint capital on *mudharabah*;
- v. Right to engage in another business;
- vi. Right to include private capital in the *mudharabah* business;
- vii. Right to supply *mudharabah* capital on the basis of *mudharabah*;
- viii. Right of the intermediary to earn profit;
- ix. Right to make a *musharakah* contract with *mudharabah* capital;
- x. Right to borrow or lend;
- xi. Right to make credit transaction;
- xii. Right to terminate contract; and
- xiii. Right to wind-up business before appointed time.

Exclusively, the above rights of partners are only relevant in *sharikah al-i'nan* because the scope of rights under other forms of business partnership is much narrowed. Some principles underpinning the rights and powers of the partners in the *sharikah al-i'nan* also cover for instance right to transact on behalf of *musharakah*, rights and powers of partners to equally share the *musharakah* property, right to obtain consent from other partners for any transaction, and right of curtailment of other partners' action (Hasanuzzaman, 1996).

Generally, all partners are liable for the debts and liabilities incurred by the *musharakah* according to their capital ratio. This is aligned with the narration (athar) of A'li r.a, the companion of the prophet (pbuh) who says: "Profit is upon their agreement and losses are distributed in accord to their capital contribution" (Kalib, 2009, p. 158). Particularly, the liabilities of the partners in *musharakah* differ from one type to another, depending on the nature of such type. For instance, in *sharikah al-mufawadhah*, all partners are jointly and severally liable for all debts. This is different from *sharikah al-i'nan* where their liabilities may be limited according to agreed terms in their agreement. Under *mudharabah*, all capital liabilities will be borne by the *rabbul mal* alone (Abd Ghadas & Engku Ali, 2011).

The contemporary Muslim scholars generally disputed on the permissibility of a modern corporation under Shariah since it is not similar to the classical *musharakah* as explained above. Some scholars such as I'sa Abduh and Taqi al-Din al-Nabhani argued that it is not accepted entirely since its structures contradict with the *musharakah* principles (Nyazee, 2010). Meanwhile, majority scholars such as Al-Khafif, Al-Zuhaili Al-Khayyat and others

accept the existing corporation under the purview of *sharikah al-i'nan* or *sharikah al-milk* and directly apply all these *musharakah* principles into the former (Al-Khalil, 2002). Accordingly, rights and liabilities of members in the company are discussed under the concept of *musharakah* to show their resemblances consistently.

8.0 COMPARISON OF MEMBERS' LIABILITIES UNDER COMMON LAW AND SHARIAH

The historical development of a corporation shows its transformation from a partnership model into an independent entity species since 18th century. In the past, all members were the owners of the company including its capital and assets and their liabilities toward it are joint, inseparable, and herein unlimited (Mohd Sulaiman et al., 2008). At present, after the introduction of separate legal entity principle, corporation is a legal entity possessing certain rights and liabilities being distinct from its members. It is duly managed by the board of directors as its employees or an agent to run its own business utilizing capital investment by its members. This transformation has resulted into separation of ownership and management between shareholders and board of directors and as such, shareholders will take less participation or do not take part at all in daily business management of the company (Abbasi, 2009).

Consequently, they are only left with certain rights attached to their share capital subscription, as provided in the company's constitutions and statutory legislation. Apart from this, upon introduction of limited liability into corporation or corporate veil which acts as a shield to the shareholders, they are not simply liable for the company's debts (Mohd Sulaiman & Othman, 2018). The Act assures that the shareholders are not liable for the company's debts but for their unpaid capital amount of their shares except in the case of unlimited liability company. According to Abbasi (2009), this dynamic change of legal business structure or business vehicle is obvious; to ultimately fulfil the maximization of profit value for the shareholders.

From a company's membership perspective, members do not act as an agent toward another and they are not the company's agents and vice versa even though they are contractually bound by the company's constitution as a covenant to their relationship. This is affirmed by the Salomon's case whereby Lord Macnaghten held that upon incorporation of a corporation, it is not in law the agent of the shareholders nor trustee for them. They are not simply liable for the former's liabilities except in the manner provided by the legal statute (Rachagan et al., 2010). Hence, according to Nyazee (2010), this non-identical relationship

renders their internal relationships as arbitrary, unclear and indeterminable. In fact, incorporating a company with a single member or known as ‘one-man’ company under Section 9(b) of the Act is possible. This dilutes the elements of a valid *musharakah* which requires at least two members be present for its formulation (Al-Zaa’mtari, 2012). All in all, the important essence of a company is its establishment as an artificial person recognized under the law regardless of the number of its members.

Musharakah on the other hand is a contractual agreement among the partners whereby they are joint owners of the partnership entity and its businesses respectively. Despite owning the partnership, they also actively run and manage the *musharakah* businesses. Their contractual rights, benefits, powers and profits enjoyed by each partner are provided under their mutual agreement and subject to the customary practices or ‘*urf*’ during their particular time. Moreover, they are also jointly and severally liable for the partnership’s debts and liabilities up to their capital ratio, in line with the Islamic legal maxim: “revenue is upon the liability” (Nyazee, 2010, p. 68). Unlike company, the *musharakah*’s structure is simple based upon a contractual relationship in the form of agency or surety. This absolutely requires a minimum number of two partners to form it, fulfilling the objective of ‘*musharakah*’ as mingling of capital that does not operate with the presence of only a sole partner or otherwise, the agency (*wakalah*) contract underlying it is thereafter not founded (Al-Zaa’mtari, 2012). Furthermore, the partners are collectively treated as a single entity and as such, their liabilities are often unlimited. Alternatively, if a person omits to involve in the business management directly, *mudharabah* contract may also be formed whereas he, as a capital provider can provide a capital advancement to his business partner, a *mudharib* acting as his agent to conduct the businesses on his behalf. In the event of losses, the former totally incurs the liability but this does not necessarily mean his liability is limited. Both *musharakah* and *mudharabah* share the same attribute in that they are grounded on the basis of *wakalah* agreement, a contractual relationship that is expressly identified.

In comparison between the rights and liabilities of members in the corporation with of partners in the *musharakah*, it is observed that all the above legal features of corporation conceptualize these rights and liabilities to be more statutory than contractual. Their rights to receive dividends, rights to vote and rights to attend the general meeting and other rights attached to the shares as well as their exemption from the corporation’s liability incurrence likely dilute their status as the “owners” of the corporation as of those in a normal partnership since the element of real participation in the management and risk assumption of business is almost diminished (Sikka & Stittle, 2017). Their rights in the company are no longer collective

but rather distributive due to its isolation from the corporation as a separate legal entity (Stein, 1976). Thus, their entitlement of rights and liabilities are not based on contractual partnership at all but rather on a legal corporation itself which regards its members as the holders of “shares” in the company. Indeed, these shares do not legally nor beneficially represent the pro rata ownership of the latter’s assets (Ireland, 1999).

Contrastingly, the rights and liabilities of partners in the *musharakah* are contractual in nature since it does not have both separate legal entity and limited liability features. All of them equally participate in the *musharakah* from capital, profit, management and risk-sharing perspectives. The principle of *wakalah*, “revenue is upon the liability” and other essential Shariah principles underpinning *musharakah* are always maintained to ensure their ownership to assets, profits, rights and liabilities in the *musharakah* are Shariah-complaint (A’thiyyah Ramadhan, 2007, p. 493). For instance, the prophet pbuh forbids a person to gain profit without incurring liability from the defect of transaction based on the hadith narrated by A’bdullah Ibn A’mr Ibn Al-A’s: “*A salaf (loan) and sale (in one contract) are not permitted...nor the profit from a thing for which the liability for loss is not borne...*” (Sunan Abu Dawud). This hadith is significant to the concept of ownership in Islam that is strongly associated with assumption of risk or liability (Abdul Razak & Saupi, 2017) and is ultimately applicable to other Shariah contracts particularly *musharakah*.

Furthermore, several scholars refuted the majority contemporary Muslim scholars’ view that a corporation resembles *musharakah*. According to Al-Qari (2015), both entities are greatly different in several aspects. For instance, the Arabic word ‘*sharikah*’, which means participation closely associated to the classical understanding of *musharakah* under Shariah, does not match with the literal meaning of corporation under common law. The latter is rather a separate legal entity distinct from its members. Secondly, the element of participation among the partners which is substantial to a valid *musharakah* is not required for the corporation since it can subsist with even one member. Hence, corporation is not similar to *musharakah* from its literal meaning until the inner features counterpart as the former is originated from the western concept unfamiliar to the concept of *musharakah* under Shariah (Al-Qari, 2015).

In short, both company and *musharakah* do not complement each other. Neither of them can be correlatively matched due to their great differences in terms of definitions, elements, structures and features. Although some contemporary scholars view a company likely akin to one *sharikah-al-i’nan* in several aspects (Zuryati, Yusoff, & Azree, 2009), it is the writers’ opinion that such resemblance is very superficial and yet their differences remain identical and

will lead to different rulings upon each other, particularly in relation to their rights and liabilities in both entities.

9.0 CONCLUSION

The different legal structures of company under common law and *musharakah* under Shariah have led to significant divergences in terms of the members' rights and liabilities in both business entities. The rights and liabilities of members are influenced by various legal structures and attributes of a company, such as the separation of ownership and management functions, limited liability concept, existence of a company as a separate legal entity distinct from its members and others. Their internal relationship is also non-identical and not based upon agency nor partnership contract. Nonetheless, the rights of members in a *musharakah* are expressly provided in their contractual agreement, be it agency or surety contract and their liabilities are often unlimited due to joint ownership of both the *musharakah* and members respectively. In developing a Shariah-compliant corporation in Malaysia, it is proposed to have a review on the current legal structures of the corporation registered under the Companies Act 2016 to conform to the Shariah principles of *musharakah* as a business vehicle model for Muslim entrepreneurs who run a shariah-compliant businesses, for instance the joint and inseparable ownership and liabilities between the members inter se and the entity itself etc. Their contractual relationship underlying a corporation must be ascertained and clearly identified so that it does not stand on its own like the current model from which the former lacks.

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