Contemporary Issues in Islamic Banking & Finance

By

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بسم الله الرحمن الرحيم

Preface

Interest-based transactions are the cornerstone of modern banking and finance. Money is regarded as a commodity. Money fetches a price in the form of interest.

The Islamic transactions, on the other hand, are free of interest and are exclusively based on profit and loss. The basic distinguishing Islamic principle is that a profit can only be earned in a legitimate transaction involving a corresponding risk of loss.

The Islamic instruments of banking and finance provide a real, viable and superior alternative than interest-based financing. Borrowing on interest has created a massive debt crisis, resulting in widespread poverty, destitution and gross inequality in the distribution of wealth.

The Islamic instruments of finance are brilliantly summarized by the writer's revered teacher, the eminent and distinguished contemporary jurist, Mufti Muhammad Taqi Usmani, in his book "An Introduction to Islamic Finance".

This book represents an attempt to deal with specific contemporary issues only, in the context of Islamic banking and finance. I hope that the topics covered would prove useful. May Allah accept this humble endeavor.

The first edition of this book covering topics 1 to 16 were written during early January 2005.

The current second edition includes Chapters 17 to 25. These chapters were written during the December '05 /January '06 recess.

M.S. Omar
Durban
April 2006

Contents

1.

Conditionality of Transactions which are Interconnected (Safqa fi Safqa)

It is an established principle of Islamic Law that, in a single agreement, one distinct contract cannot be made conditional upon another distinct contract, so that the validity of the whole is dependent on the performance of the individual contracts.

The distinguished Hanbali jurist Ibn Qudama (RA) gives the following examples:

بعتك داري هذه على ...ان تبيعني دارك او
على ان تؤجرني كذا...

"I sell you this house, on condition that you sell me your house, or, on condition that you lease to me a certain asset…"

It is apparent from this statement that two separate contracts are conditional upon each other, in terms of a single agreement. This is prohibited because according to the majority of jurists, no consideration passes for one of the contracts, and this is regarded as interest (RIBA).[1]

1. See AL MUGNI OF IBN QUDAMA, vol 4, p313

Furthermore, the validity of both contracts depends upon the fulfilment of suspensive conditions: **"I sell you my house, on condition that you lease me your shop".**

The sale of the house is dependent on the lease of the shop - an event which may or may not occur, with the result that the operation of the whole contract (incorporating two distinct contracts, sale and lease) is suspended upon the fulfilment of an uncertain event.

It is an established principle of contracts of sale and leases that it is not permissible to suspend their operation upon the fulfilment of an event or contingency which may or may not occur. This is described as تعليق (TALEEK).

In the context of Islamic banking, it is critical that the individual transactions are separate, and not connected to each other, as stated above. For example, a contract cannot be concluded between the client and the bank in the following form:

"Client hereby sells his property (as defined) to the bank, for a specified price, subject to the condition that the bank agrees to lease the property back to the client upon stipulated conditions"

The valid alternative is that the contingent contract should be separate, and should be expressed in the form of an enforceable unilateral promise which should not be a term of the contract itself.

In such a case, the sale transaction is separate and independent of the unilateral promise. In the hypothetical situation referred to above, the client sells the property to the bank. The bank in turn separately and apart from the sale, promises to lease the property back to the client upon mutually agreed terms. If the breach of the promise causes the client actual loss, the client is entitled to recover such loss from the bank. The difference between a promise and a contract is more fully discussed in chapter 3.

2.

Future Sales and their Enforceability

The Muslim jurists are of the view that future sales, as described below, are not permissible.

A future sale refers to the sale of a commodity, which does not require to be manufactured, and in terms of which:

(a) the seller undertakes to deliver the commodity at an agreed future date.

(b) the buyer undertakes to pay the agreed price upon delivery of the commodity, or, thereafter.

A future sale in this context therefore means that the reciprocal exchange of consideration (the commodity and price) occur, not at the time of the agreement, but at an agreed date in the future in terms of an overriding agreement.

Such a future sale is invalid in Islamic Law for inter alia the following reasons:

(i) the reciprocal performances under the contract are attributable to a future date.

(ii) The exchange of performances or consideration occur in the future, with the result that they fall within the prohibition embodied in the Hadith بيع الكالئ بالكالئ (the sale of debts or future obligations, one against the other, is prohibited).

(iii) The seller in many cases does not own the commodity at the time of the contract. Such sale is prohibited in accordance with the express text of the Hadith.

نهى رسول الله صلى الله عليه و سلم
عن بيع الانسان
ما لا يملك
لا تبع ما ليس عندك

(iv) In some cases, the commodity is non-existent at the time of sale. This is prohibited by the majority of the jurists.

It must be borne in mind that where the future sale relates to the manufacture of a specific commodity, the sale is valid because it falls within the category of ISTISNA, namely, a contract in terms of which the seller undertakes to manufacture a specific clearly-defined commodity for an agreed price payable upon mutually agreed terms of payment.

The valid alternative to future sales is that the parties should conclude bilateral promises as discussed briefly in the next chapter.

3.

Promises and their Enforceability

A future sale contract creates bilateral promises of performance at a future date. A sale only comes into existence at the time of the delivery of the commodity, at the future date, by the way of offer and acceptance.

The question therefore arises as to whether such bilateral promises or undertakings are binding and enforceable according to Islamic Law.

The Islamic Fiqh Academy of Jiddah has resolved in accordance with the Maliki school that a unilateral promise (made by one party) is binding and enforceable (resolution 302, fifth session, Kuwait).

There are precedents in Islamic Law for the enforceability of bilateral promises in the case of commercial need.

The sale known as BAI UL WAFA بيع الوفاء is a category of sale recognised by the Hanafi school. The essence of this sale is that the seller is entitled to the return of the thing sold against payment or return of the price to the buyer. The sale

is therefore subject to the condition of **"buy back"** at the original price. The sale has been held to be valid provided the condition of **"buy back"** is not a condition of the sale itself, but is expressed as bilateral promises, separate from and independent of the contract of sale itself.

This is expressed by the distinguished Hanafi Jurist Qadi Khan known as follows:

و ان ذكر البيع من غير شرط، ثمّ ذكر
الشرط على وجه المواعدة قد تكون لازمة،
فتجعل
لازمة لحاجة الناس

"if the sale is concluded without reference to the "buy back" condition; thereafter the "buy back" condition is expressed separately in the form of bilateral promises, the sale is valid; and the promises are enforceable because of commercial need.

(See: FATAAWAH KHAANIAH: chapter on conditions which render a sale void)

The argument may be raised that the recognition of such bilateral promises, between contracting parties as being enforceable, would blur the distinction between the mutual promises and the contract itself. The answer to this argument is as follows: :

(a) The mutual promises do not themselves give rise to a contract of sale. The contract is only concluded on the future date when delivery and payment occurs by way of offer and acceptance at the relevant time.

(b) A binding sale (as opposed to bilateral promises) produces immediate consequences which flow automatically upon conclusion of the contract. Ownership passes immediately from the seller to buyer. The buyer in turn is obliged to pay the agreed price. If the buyer goes insolvent the seller has a concurrent claim according to the Hanafi school. In terms of the other schools the seller is entitled to the return of his goods (if unsold).

(c) On the other hand, bilateral promises do not give rise to immediate legal consequences following upon a sale. If the promisor is unable to fulfil his promise for a valid reason, he is not liable to the promisee for compensation or otherwise. If the promisor breaches his promise without valid reason, and this breach causes an actual loss to the promisee, the latter is entitled to recover the actual loss.

In the context of Islamic banking, it becomes necessary to use unilateral promises in relation to different financial instruments. For example, in a Murabaha transaction, the client promises, or undertakes to purchase the commodity (in terms of a Murabaha sale) after the bank has acquired the same from the supplier and has taken actual or constructive

possession thereof. If the client refuses to conclude a Murabaha sale at the relevant time, then he or she is in breach of promise (to purchase). The difference between the price paid by the bank to the supplier (under the first sale), and the proceeds of realizing the asset in the open market, represents the actual direct damages that would be suffered by the bank. Such damages may be recovered by the bank from the client as a result of breach of promise on his part to conclude a valid Murabaha contract at the relevant time.

ILLUSTRATION 1:

BREACH OF PROMISE (MURABAHA)

Price paid to the supplier in terms of the first sale	R 100 000,00
Less: proceeds of realizing the commodity in the open market	R 75 000,00
actual direct damages recoverable from client.	**R 25 000,00**

Similarly, in the case of IJARA (leasing) the bank acquires the asset from the supplier and takes possession thereof (actual or constructive). The client promises at inception to lease the asset from the bank upon mutually agreed terms. The client reneges on his promise, with the result that the bank suffers an actual direct loss.

This loss may be recovered from the client as a result of breach of promise. It may take the form of the difference recoverable upon realisation of the asset (see illustration 1 above), or, the actual loss may represent the difference between the agreed rentals payable to the client over the period, and the actual rental received in the open market as a consequence of leasing the asset to a third party.

ILLUSTRATION 2: DAMAGES (IJARAH)

Total rental that would have been received by the bank over agreed period (say, 36 months) at R 10 000 per month	R 360 000,00
Less: total rental received by the bank Over 36 months as a result of leasing the asset to a third party at R 8000 per month	R 288 000,00
actual direct damages recoverable from client	**R 72 000,00**

In summary, therefore, a promise whether unilateral or bilateral, which is independent and separate from the sale or lease itself, is binding and enforceable. The rationale for such enforceability is that the promisee (the other party) is induced to enter a contract as a direct result of the promise, with the result that the promisee suffers prejudice or loss as a consequence of the breach of promise. As the eminent Maliki jurist, Qarafi states:

قال سحنون: الذى يلزم من الوعد :

قوله اهدم دارك و أنا أسلفك ما تبنى به،

او اشتر سلعة و أنا أسلفك،

لانك أدخلته بوعدك فى ذلك

"Imam SENUN states: in respect of promises which are binding and enforceable: for example: "demolish your house, I will loan you the cost of reconstruction thereof"; or,
for example: "purchase the commodity, I will loan you the price thereof" these promises are enforceable because they had induced the promisee to conclude the relevant transaction"

(See: Furuq by QARAFI: Vol 4, p 24)

A promise couched clearly in the form of an undertaking is enforceable in a secular Court of a western country. The Court may at the instance of the promisee bank grant an Order of specific performance, or, damages suffered by the promisee as a direct result of the breach of promise.

4.

Hamish Jiddiyah and Arbun

Hamish Jiddiya is an amount or deposit which is paid by the client to the bank at the inception of dealings (at the time of promise) in anticipation of concluding a Shariah compliant transaction, such as Murabahah or Ijarah. The bank is obliged to hold the deposit in trust on behalf of the client, and is prohibited from utilizing the same in any manner whatsoever. The bank may on instructions of the client invest the sum in a participation account, any profit accruing thereon in the normal course being for the benefit of the client. If the client breaches his promise to purchase or lease the commodity in terms of a Shariah compliant transaction at the relevant time, then the bank is entitled to appropriate the anticipation deposit in settlement of the actual direct damages suffered by it as a consequence of the breach of promise. Any surplus to accrue to the client, the bank being entitled to claim any resultant deficit from the client.

Arbun, on the other hand, is an amount paid by the purchaser pursuant to a binding and valid sale in terms of which the purchaser has the option to withdraw therefrom.

If the purchaser elects to resile from the sale, the amount or deposit paid by him is forfeited in favour of the seller. If he confirms the sale, the amount or deposit so paid is offset against, and thereby reduces, the purchase price. The Arbun is recognised by the Hanbali School. The great Hanbali jurist Ibn Qudama states as follows:

و العربون فى البيع: هو
ان يشترى السلعة فيدفع الى البائع
درهما او غيره، على انه إن أخذ السلعة
احتسب به من الثمن، وإن لم
يأخذها فذلك للبائع

See:
(AL MUGNI: Vol 4 p 289)

"Arbun in this context of sale means: the purchaser acquires a commodity, and pays an amount to the seller, on the basis that if he (the purchaser) takes the commodity, the amount so paid by him will be offset against the price. If he does not take the commodity the amount will accrue to the seller"

The Arbun in this context is analogous to a penalty for a

non-performance on the part of the purchaser. The amount forfeited need not be commensurate with the actual loss (if any) suffered by the seller.

Article 2.5.6. being the Shariah standard set by the Shariah board of AAOIFI provides that the bank is entitled to take an amount as Arbun after concluding a valid Musharakah transaction. The article goes on to provide that it is preferable that the bank offsets such amount against its actual loss, and pays any surplus to the client. The actual loss is defined as the difference between the original price and the lower proceeds upon realisation of the asset in the open market.

Similarly, article 3.3.1, dealing with ISTISNA, provides that the manufacturer of an article is entitled to take an amount as Arbun which is offset against the price. If the buyer however cancels the contract (without valid reason), then the amount paid as Arbun is forfeited in favour of the manufacturer. The article goes on to provide that it is preferable that the Arbun amount is offset against the actual damages suffered by the manufacturer (seller), with the result that any surplus be repaid to the buyer.

Article 6.7 of the Shariah standard (AAOIFI) provides for the inclusion of a penalty clause in contracts of Istisna, limited to the situation where the manufacturer/ contractor fails to deliver the completed article or commodity on the agreed stipulated date. In this case, the contractually agreed penalty will apply for the period of delay (eg R 1000 for each day of

delay, calculated as from the date of default to the date of completion and delivery). The penalty however would only apply where the cause of the delay is not attributed to supervening factors beyond the control of the manufacturer/ contractor, such as war, riots, strikes, inclement whether etc. Such penalty clauses may also be applied to contracts of Ijarah.

5.

Sale of Debts (Bai'-al-Dain)

It is necessary to understand briefly the Shariah position in connection with the sale of debts. This subject may be categorised as set out below.

1. **Sale of Debts Against Debts in the future (obligations for obligations).**

This relates to the sale of debts against debts. For example, the seller sells and the buyer purchases 1000 units of specified fabric for a price of R 100 000,00. the sale is contracted on the basis that the price will be paid, and the fabric delivered, after two months as from the date of the conclusion of the agreement.

In this example, the seller's obligation to deliver the specified quantity of fabric on the agreed future date is a debt (DÂIN) which vests in the seller. Similarly, the buyer's obligation to pay the agreed price on the agreed future date is a debt (DÂIN) which vests the buyer. Both these contractual debts are sold or exchanged, one against the other. In other words, there is a sale of obligations or debts which are

reciprocal, at an agreed future date.

The overwhelming majority of jurists are of the view that the sale of debts or obligations as described above is prohibited in Islamic Law.

The basis of the prohibition is the well known statement of the Holy Prophet Muhammad (SAW) which is recorded in a number of works of Hadith:

ان النبی صلی الله علیه و سلم

نهی عن بیع الکالئ بالکالئ

"The Holy Prophet (SAW) prohibited the sale of debts for debts".

(see for example: Mustadrak, vol 2, p65,
Hadis number 2342 and 2343)

2. **Sale of the Debt to the Debtor himself**

This category relates to the sale of the debt by the creditor to the debtor himself for a price or consideration which is payable immediately (and not at a future date).

For example, the debtor is indebted to the creditor for a sum of money **("the debt")**. The creditor sells the debt to the debtor for a consideration, such as a quantity of fabric to be

paid or delivered immediately (at spot).

It is important to note that the sale of the debt to the debtor is subject to the normal conditions governing sales. One of these conditions is that the seller cannot sell a commodity until he has taken possession thereof. It follows that the buyer in a contract of Salam cannot sell the commodity (Muslim Fih) to the seller (Muslim Ilaih) without taking possession thereof. In salam, the seller undertakes to deliver the specified goods on a fixed future date, against payment of the price upfront at the time of the conclusion of the contract of salam. As Imam Khasani (RA), a leading Hanafi jurist states:

و لا يجوز بيع المسلم فيه لان المسلم فيه مبيع،
ولا يجوز بيع المبيع قبل القبض

"it is not permissible to sell the specified commodity (Muslim Fih) (to the seller thereof) because the Muslim Fih is the thing sold. It is not permissible to sell the thing sold prior to its possession"

In the context of salam, because the commodity to be delivered at a future stipulated date is a debt vested in the seller, it is a precondition that the buyer takes possession of the debt (in the form of the commodity) before he sells it in his capacity as seller to the buyer (in this case, Muslim Ilaih).

It is obvious that the purchaser is prohibited from purchasing a debt at a price exceeding its face value which amount is

payable by him to the seller at a future date. . This clearly amounts to a Riba transaction. For example, the debtor owes the creditor a sum of R 1000 ("the debt"). The creditor (as seller) sells the debt to the debtor, (as purchaser) for a price of R1500,00 which amount is payable 120 days as from the date of the conclusion of the transaction.

3. Sale of the Debt to a Third Party (other than the Debtor)

The sale of a debt to a third party (other than the debtor) must be distinguished from Hawâla. The latter is an assignment of obligations. Hawâla is permissible according to all schools of jurisprudence.

In the case of Hawâla, the debt is transferred or assigned to the third party with the consent of the creditor. If the third party assignee goes insolvent or disputes the debt, then, the creditor has a right of recourse against the original debtor automatically according to the Hanafi school. According to the Hanbali school, this right of recourse is only available if the same was contractually agreed on the basis that the third party assignee undertook that he had the financial means to satisfy the debt.

On the other hand, in the case of the sale of the debt, the buyer of the debt (being the third party) steps into the shoes of the seller (the original debtor) and thereby acquires all the rights and obligations of the seller, with the result that he (the original debtor) is released. It follows that the creditor has

no right of recourse against the original debtor, if the third party purchaser goes insolvent or disputes the debt.

It follows that the Hanafi and Hanbali schools prohibited the sale of a debt to a third party (other than the original debtor) because of the risk and uncertainty as to whether payment would be made or not. This uncertainty (GHARAR) tainted the transaction. Imam Muhammad (RA) states as follows:

لا ينبغى للرجل اذا كان له دين ان يبيعه حتى
يستوفيه لانه غرر فلا يدرى ايخرج ام لا يخرج-
وهو قول ابي حنيفة رحمه الله

"it is not permissible for a creditor to sell his debt until he takes possession thereof, because (such sale) amounts to GHARAR or uncertainty. It is not known (at the time of sale) whether the debtor will pay or discharge the debt"

(See: Muwatta of Imam Muhammad:

باب الرجل يكون له العطايا او الدين على الرجل
فيبيعه – كتاب الصرف و ابواب الربا)

The Maliki school has permitted the sale of a debt to a third party subject to certain conditions. Amongst these conditions, are the following:

(a) the debtor must acknowledge the debt.

(b) the debt should be of a category which may be sold prior to its possession. Foodstuffs cannot be sold until possessed.

(c) the debt must be sold for a consideration which is of a different genus. If the exchange of consideration (debt and price) are of the same kind or genus, then the exchange must be equal, with no excess passing. For example, the seller sells a monetary debt of R100 for R100 and not more.

(d) The sale of gold for silver (or vice versa) is not possible because mutual exchange of possession is necessary at spot. This is known as SARF.

(e) The payment of the price must be immediate upon conclusion of the sale, otherwise the sale of debt for debt in the future would occur, and this is prohibited as stated above under the first category.

(See Muktasar Khalil, with commentary by Zarqani).

The Shafi'i view is more complex. The majority of Shafi'i jurists prohibit the sale of a debt to a third party (other than the debtor). Some jurists who are inclined to permit the sale stipulate that the debt be possessed at the time of the contract (which effectively prohibits the sale by making possession of the debt a precondition).

There are other Shafi'i jurists who have not mentioned possession of the debt as a precondition to its sale, and have accordingly permitted the sale of a debt to a third party, provided that the subject matter of the debt or sale is not money or other consideration which constitutes AMWÂL AL RIBA[1] (or categories of property in respect of which riba or interest is competent).

In the latter case, the exchange on both sides must be exactly equal in quantity (without excess), and must be effected immediately at spot, any excess at spot or in the future amounts to a Riba transaction. This is the general rule.

1. The AMWÂL AL RIBA included, apart from money, the six categories specified in the Hadith, namely the exchange of gold for gold, silver for silver, wheat for wheat, barley for barley, date for date, salt for salt. These were specifically mentioned because they were used as a medium of exchange (as money) by the Arabs in their commercial dealings.

   See: The Historic Judgement on Interest, by Justice Mufti Muhammad Taqi Usmani, Idaratul Maarif, Karachi, p 40-41.

6.

Discounting of Cheques and Money Bonds

The foregoing discussion on the sale of debts indicates that the contemporary practice of discounting cheques is not permissible. In essence, it amounts to the sale of money for money. All the schools of jurisprudence are unanimous that the exchange of money must be equal on both sides at par value, with no excess. Discounting is in fact a money lending transaction involving interest which is prohibited.

The same applies to the sale of bonds which represent loans. These money bonds are issued by government or private companies to fund projects. These bonds cannot be sold at a profit because the excess amounts to interest. These bonds are essentially interest-bearing instruments. The negotiation of these bonds are only permissible at their face value on the following basis:

1. According to the Hanafi and Hanbali schools, these bonds cannot be sold because such sale amounts to the sale of a debt to a third party, and this is prohibited absolutely by these schools.

2. According to the Maliki school and certain Shafi'i jurists, the sale of these bonds to a third party is permissible, provided the sale is at the face value thereof, with no excess passing. Where the consideration is money, or, AMWAL AL RIBA, these jurists state that the exchange must be absolutely equal (that is, at par value), with no excess consideration passing.

3. All the schools are unanimous that the negotiation of the bond may be effected by way of Hawâla or assignment of obligations. The holder of the bond borrows an amount equal to the face value of the bond or negotiable instrument. The holder thereafter assigns the obligations under the bond to the third party/ lender, with the result that the rules of Hawâla would apply. In terms of the Hanafi school, the third party lender has a right of recourse against the holder of the bond in the event of default in payment.

Negotiable instruments such as cheques and bills of exchange, on the other hand, may be permissibly negotiated between the bank and the client in terms of two separate transactions, namely:

1. **First transaction:** the holder of the cheque or other negotiable instrument authorises the bank as his agent to collect the amount of the cheque upon the due date of maturity. As consideration for this

service, the holder undertakes to pay the bank an agreed fee which is unrelated to the period of maturity.

2. **Second transaction:** the bank lends the client as holder of the cheque an interest-free loan equal to the face value, but less the agreed agency fee, which loan is payable on the date of maturity.

3. The bank on the due date of maturity collects the amount of the cheque from the drawer/ debtor. The bank deducts the agency fee, and offsets the balance against the interest-free loan advanced to the client. It must be emphasised that the agency fee must not be linked to the amount of the loan itself.

7.

Tacit Sales (Bai Bil Taati)

Tacit sales are those sales which are concluded by conduct. They cover two situations. Firstly, where the parties conclude a sale without expressing offer and acceptance. For example, the purchase of a loaf of bread. The buyer takes the loaf from the shopkeeper and pays the price. No words of offer and acceptance are expressed or uttered by either party.

Secondly, the one party expresses an offer to purchase. For example, **"give me this article for R 100".** The other party accepts by conduct, without expressing an acceptance.
Both situations constitute valid tacit sales in Islamic Law. Tacit sales by conduct cover all classes of sales and are recognised by the overwhelming majority of jurists.

The distinguished jurist Ibn Qudama states:

و لان الايجاب و القبول إنما يرادان للدلالة على
التراضى، فاذا وجد ما يدل عليه من المساومة و
التعاطى قام مقامهما

" offer and acceptance indicate contractual consent. If such consent is evidenced by conduct, then such conduct takes the place of offer and acceptance"

The question however arises as to whether tacit sales may be validly contracted in the context of Murabahah transactions. The fundamental distinction between a murabaha transaction and an interest-bearing loan is as follows:

1. In the case of an interest-bearing loan, the lending conventional bank charges interest on the loan, and thereby assumes no risk whatsoever.

2. In the case of Murabahah, however, the bank purchases the commodity and takes actual or constructive possession thereof. In doing so, the bank assumes the risk (of destruction) of the commodity as a result of its ownership; thereafter in terms of a separate sale, the bank sells the commodity to the client on a cost plus agreed profit basis, in which event ownership and risk in the commodity passes to the client as a consequence of the second sale. It follows that the bank makes a profit as a result of the sale of a commodity. It is entitled to the profit as a result of the risk which it has assumed, and for no other reason.

In practice, the client normally takes possession of the commodity on behalf of the bank in his capacity as an agent of the bank.

Thereafter, the client in his capacity as purchaser acquires the commodity from the bank in terms of a separate sale concluded by offer and acceptance. It follows that, if such offer and acceptance were to be permitted **tacitly**, almost immediately after the client has taken possession of the commodity, on behalf of the bank, then the above mentioned distinction between a Murabahah sale and an interest-bearing loan would become blurred. The transaction would be analogous to an interest-bearing loan, with the bank effectively assuming no risk. In the context of the use of Murabahah by Islamic banks, therefore, it is not permissible to conclude such contracts tacitly[1].

1. See the article on tacit sales, BAI BIL TAATI, by Mufti Mufti Muhammad Taqi Usmani, in his incisive collection, Buhus Fi Qadaya Fiqhiya Muasira, at p 49-55.

8.

Administration and Guarantee Fees

The bank is entitled to charge an administration fee for services rendered by it in connection with transactions undertaken in the ordinary course of its business. The administration fee must be commensurate with actual costs incurred in rendering the relevant service. This may be calculated by having regard to a fair and equitable formula which is pro rated to the amount of each transaction financed by the bank. The bank cannot under any circumstances charge an administration fee based on the amount financed itself, without reference to the actual costs incurred in rendering the service. A suggested formula for computing administration costs in respect of a particular transaction is as follows:

$$\text{Fee} = \frac{a}{b} \times p$$

where:

a = the amount of the relevant transaction;
b = the total aggregate value of transactions concluded to date (of the relevant

transaction).

p = the ratio in which the total costs incurred to date bears to the total aggregate value of transactions concluded to date (of the relevant transaction)

The bank may also arrive at a proportion or percentage, provided the same does not exceed the market rate for similar services based on actual costs incurred (and not on the amount of the transaction itself).

The Muslim jurists have permitted an agent or broker to charge a percentage fee based on the price. On this basis, the fee charged is higher, where the price obtained is higher, despite the fact that no extra work or effort is involved. Similarly, an administration charge may be levied, based on actual costs incurred, and not the monetary value of the transaction itself, but expressed as a percentage.

The distinguished Hanbali jurist Ibn QUDAMA states:

ويجوز أن يستأجر سمسارًا يشترى له ثيابا...فان عين العمل دون الزمان فجعل له من كل ألف درهم شيأ معلوما صح ايضاً

"It is permissible to hire an agent or broker with a mandate to purchase cloth. If no time-period is fixed (for performance of mandate), and the agent's labour only is hired, then it is permissible to fix a fee on the basis that the agent will receive a fixed amount for every 1000 dirhams (of cloth purchased on behalf of his principal)"

See: MUGNI, Rule 4197, كتاب الاجارات
The Book of Hire

The great Hanafi jurist IBN AABIDEEN (RA) states that the later Hanafi jurists permitted an agent or broker to charge a fixed percentage fee based on the value of the transaction (the fee would increase, if the transaction value increases). This permissibility was given based on commercial practice and need.

وفى الدلال والسمسار يجب أجر المثل،
وما تواضعوا عليه ان فى كل عشرة دنانير كذا
فذلك حرام عليهم...فجوّزوه لحاجة الناس اليه.

(See: RAUDDUL MUHTAAR:

باب ضمان الاجير- مطلب : فى اجرة الدّلال

Book of Hire)

"the broker or agent is entitled to a market-related fee. The commercial practice of charging a fixed amount for every 10 dinars was not (initially) permissible. It was thereafter permitted based on commercial need"

Similar principles apply to a fee charged by the bank for issuing a guarantee. It is obvious that no fee can be charged for the issue of the guarantee itself, without reference to the work and underlying costs involved. This is so because no profit or remuneration may be charged, in the absence of assuming a risk, or, in the absence of rendering services or labour. A fee charged in these circumstances would neither be in consideration of labour nor in respect of any risk assumed by the bank.

In summary, therefore:

1. The bank is entitled to charge an administration fee which is calculated in accordance with actual costs incurred (and not solely the value of the transaction itself), provided such fee does not exceed the market rate.

2. The fee may be based on a fair and equitable formula, or, otherwise, expressed as a percentage, or, based on a tariff, having proper regard to actual costs incurred, and services rendered, in connection with the particular transaction.

3. the bank is not entitled under any circumstances whatsoever to charge an administration or guarantee fee, based on pure transaction value (for the transaction itself) which does not represent a fee for actual administration costs incurred in respect of the relevant transaction.

1. See Buhus Fi Qadaya Fiqhiya Muasira, Mufti Taqi Usmani (OP CIT), pages 205 to 209, and at page 220 to 223.

See also Shariah standard 7.1.2 (section 5) (AAOIFI), which sets the market rate as a limit to the fee.

9.

The Bank as Mudarib: Liability for expenses

The relationship between the depositors and the bank is that of rabb-ul-mal and mudarib. The depositors as the contributors of capital are regarded as whole as the rabb-ul-mal, whereas the bank, as a separate legal entity, is regarded as the mudarib.

It follows that the depositors conclude a contract of Mudarabah with the bank in terms of which the depositors collectively as the rabb-ul-mal contribute the capital and the bank contributes the labour or effort in managing the partnership. The parties agree to share profits and losses in an agreed ratio at the inception of the partnership.

The bank is entitled to its share of the profit in consideration for its labour. The bank itself as a separate juristic entity is the Mudarib, all indirect expenses incurred by the bank in conducting its operations must be borne by the bank, and not the Mudaarabah partnership. These indirect expenses include salaries, rental, water, electricity, maintenance of equipment and ancillary expenses.

Direct expenses, on the other hand, are those which are connected directly with the Mudaarabah partnership which arise in the ordinary course of its partnership business. These expenses must be borne by the Mudaarabah partnership itself. The following resolution was taken by the supreme Shariah Board of Albaraka at its fourth session:

"As regards general administrative fixed expenses incurred by the bank in conducting its various operations, these expenses must be borne by the bank itself. The bank receives a share of the profit in its capacity as madarib for the labour undertaken by it, hence it must bear these indirect expenses. Direct expenses however must be borne by the Mudaarabah partnership in accordance with its rules".

(See: Resolution 4/1: forth session)

It must be noted that the contemporary Shariah experts have recognised a company or other body corporate as a separate legal person, with rights and obligations (on the same basis as a natural person). On this basis, the bank is regarded as a separate legal person, which is the mudarib itself, and which acts through its authorised Board of Directors, officers and employees. This was recognised by the supreme Shariah Board of Albaraka in the following resolution (no. 10/10):

1. **"The bank as a separate legal person or juristic entity is the mudarib. The bank itself as the mudarib receives the aggregate capital of the**

the depositors for the purposes of investment on the basis of Mudaarabah. The bank itself as the mudarib is vested with rights and obligations (as opposed to the general body of shareholders, the board of directors or the chief executive officer)."

2. "Any changes in the shareholding or directors of the bank does not affect the relationship between the depositors as rabb-ul-maal and the bank as mudarib; because the depositors are protected in the event of negligence or misconduct on the part of the bank (despite changes in shareholding) in accordance with the ordinary rules of TA`ADDI and TAQSIR governing partnerships such as Mudaarabah."

3. "The aforegoing is subject to the following: a depositor may explicitly stipulate that his or her investment as rabb-ul-maal is subject to the condition that there be no change in shareholdings or directors and managers or one or more of them. A breach of this stipulation would entitle the relevant depositor to withdraw his or her investment in the Mudaarabah (which by virtue of the said stipulation is regarded as a limited Mudaarabah".[1]

1. See generally, unpublished arabic article, by Mufti Taqi Usmani on the subject of "joint mudaarabah with financial institutions"

10.

Premature Withdrawal of Depositor

The classical Muslim jurists express the view that any party to a Mudaarabah contract may terminate the contract at any time. In this regard, the well known Hanafi jurist Imam Kasani states:

واما فقه هذا العقد (يعنى المضاربة) فهو انه عقد غير
لازم، ولكل واحد منهما اعنى رب المال و
المضارب الفسخ، لكن عند وجود شرطه وهو علم صاحبه

"A Mudaarabah contract is not binding in the sense that any party whether rabb-ul-maal or mudarib is entitled at anytime to terminate it, after giving due notice to the other party"

See: BADAI-US-SANAI, vol 6, p109

Mufti Taqi Usmani in his incisive book "An introduction to Islamic Finance" expresses the view that the parties are bound by a stipulation or term in the contract to the effect that neither party shall be entitled to terminate the contract, except in defined situations. (See pages 52 to 53).

Shariah standard 4.3 (AAOFI) expresses the position as follows:

"the original position is that the contract of mudarabah is not binding. This means that a party may terminate the contract. Provided that the right to terminate the contract is lost in the following situations:

1. **If the mudarib has already commenced business, then the mudarabah partnership becomes binding and continues until actual or constructive liquidation thereof.**

2. **If the parties have agreed on a fixed period for the mudaarabah partnership, then neither party is entitled to unilaterally terminate the partnership prior to the expiry of the agreed period, without the consent of the other."**

In any event, if an investor prematurely and unilaterally withdraws his or her investment (prior to term) by closing his or her account, the applicable ruling is as follows:

(a) If the investment portfolio consists exclusively of cash and receivables (debts), then the return of the depositor's capital is subject to final accounting at the end of the period. Payment in advance is therefore made on account subject to final accounting at the

end of the period based on actual profit and loss, with the result that the depositor is liable for his or her share of loss, and benefits to the extent of his or her share of profit.

(b) If the portfolio consists of both cash and property (movable and immovable) to the extent that the majority assets consists of tangible property, then the portfolio itself may purchase the share of the outgoing depositor who has so withdrawn his/ her investment. The price may be fixed by proper valuation of the portfolio assets, or, otherwise by mutual consent. It is not permitted to have recourse to the original investment because this amounts to guaranteeing the return of capital (which constitutes riba or interest)[1].

1. See: generally, unpublished arabic article of Mufti Taqi Usmani on the subject of mudaraabah in the context of financial institutions, section dealing with unilateral withdrawals.

11.

Pledges and Possessions

The general rule is that a pledge of a thing in Islamic law is only binding, once the pledgee / creditor has taken actual or constructive possession thereof. This principle is expressed by the eminent Hanbali jurist Ibn Qudamah as follows:

لا يلزم الرهن الاّ بالقبض

"A pledge is not binding, unless the creditor has taken possession of the thing pledged"

See: AL MUGHNI, rule 3275
Vol 4, page 399

The Hanafi jurists however have permitted the creditor/ pledge to lend pledged article or thing back to the pledgor/ debtor, for use by the debtor, without effecting the validity of the pledge, which, despite the lending-back for use, remains of full force and effect. This means that the creditor enjoys a secured preference over the proceeds of the pledged thing (so lent) in preference to the other creditors. This principle is expressed by the well known Hanafi jurist Imam Marginani (RA) as follows:

واذا أعار المرتهن الرهن للراهن ليخدمه
او ليعمل له عملا فقبضه ... و للمرتهن أن
يسترجعه الى يده لان عقد الرهن باق... الا ترى انه لو
هلك الراهن قبل ان يردّه على المرتهن كان
المرتهن أحق به من سائر الغرماء

"If the creditor lends the pledged thing to the debtor (the pledgor) in order to enable the debtor to use the pledged thing, then the creditor is entitled to retake possession of the pledged thing at any time. This is so because the contract of pledge remains valid at all material times. It follows that, if the debtor dies prior to returning the pledged thing, then the creditor enjoys a secured right over the proceeds of the pledged thing, in preference to the remaining creditors of the debtor"

See HIDAYAH, Book of Pledge, under the section dealing with disposition of pledged property -

باب التصرف فى الرهن

Based on the Hanafi view, the bank or financial institution should take actual or constructive possession of the pledged thing at the inception of the contract, and thereafter lend the pledged thing back to the debtor, without affecting the validity of the pledge. In this regard, the bank should as evidence of constructive possession, retain the underlying documents evidencing the pledge (such as title deeds, mortgage or notarial bonds, log book etc) and thereafter lend the pledged thing back to the debtor, without losing the rights attaching to the pledge, as stated above. By retaining the documents of pledge, the debt remains secured. From an Islamic and legal perspective, the following suggested clause may be inserted in the underlying contract:

"1. The purchaser acknowledges that he or she or it has pledged the thing sold hereunder to the seller as security for the payment of the price hereunder.

2. The purchaser acknowledges that pursuant to such pledge the purchaser had given possession of the thing sold hereunder to the seller, and the seller had in turn lent the thing to the purchaser for use by the purchaser, without affecting the validity of the pledge which pledge shall remain valid at al material times.

3. The purchaser acknowledges that the seller shall be entitled to retake possession of the thing at any material time, and shall further be entitled to exercise its rights as pledgee in the event of default on the part of the purchaser for any reason whatsoever, including the insolvency of the purchaser.

4. The purchaser shall not be entitled to dispose of the pledged thing hereby sold in any manner whatsoever without the written consent of the seller for the duration of this agreement and as long as any amount is owing to the seller under this agreement:"[1]

Such a clause regulating the pledge of the thing sold as a condition of the sale itself is permitted in terms of the Hanbali school.[2] If the pledge is regulated in terms of a separate agreement, then its validity is unanimously recognised.

1 See generally, BUHUS FI FIQHIYAH QADAYAH, op al at p 14 to 17.

2 See AL MUGHNI, IBN QUDAMA, vol 4, rule number 3360
See also Shariah standard: 3.3.2, on constructive possession, namely that possession of the underlying documents themselves is sufficient for constructive possession, for purposes of pledge.

12.

Reservation of Ownership

Reservation of Ownership has become a common feature of contemporary sale transactions. It means that the seller sells the goods subject to the condition that ownership thereof does not pass to the buyer unless the full purchase price is paid. If the buyer goes insolvent, the seller enjoys a secured right over the proceeds of the unsold goods, which are still in the possession of the buyer at the time of insolvency. A reservation of ownership clause in a contract of sale therefore provides the seller with security, in the event of non-payment of the price by the buyer, in respect of the unsold goods still in the possession of the buyer.

Such a reservation of ownership condition is not regarded as valid according to Islamic Law, because it is contrary to the essence of the contract of sale[1]. Upon conclusion of the sale, ownership of the goods sold passes automatically from the seller to buyer.

See: Shariah standard (AAOFI) 4.4.3 under the chapter dealing with securities (الضمانات) which provides as follows:

> "the seller is not entitled to stipulate that ownership of the goods sold shall not pass, as security for the price, because the passing of ownership is an automatic consequence of the sale itself"

A reservation of ownership in these circumstances in favour of the seller effectively changes the character of the transaction from sale to what is analogous to a form of pledge in the seller's favour. The goods sold may however be pledged by the buyer to the seller as stated in the chapter dealing with possession and pledges.

As a consequence of the immediate passing of ownership upon conclusion of the sale, the Hanafi school is of the opinion that the seller enjoys a concurrent claim for the payment of the price, together with the general body of concurrent creditors, on a proportionate basis, in the event of the buyer's insolvency. This view is expressed by article 295 of the Ottoman code, Majalla, an authentic code of Hanafi Fiqh, as follows:

اذا قبض المشترى المبيع ثم مات مفلساً قبل
نقد الثمن فليس للبائع استرداد المبيع بل يكون اُسوة
للغرماء

"If the buyer takes possession of the thing sold (with the permission of the seller), and thereafter dies in insolvent circumstances, but before paying the price, the seller does not have the right to retake possession of the goods, but enjoys a concurrent claim together with other concurrent creditors, against the insolvent estate."

The majority of the jurists including the Shafi'i, Maliki and Hanbali schools are of the view that the seller has an option upon the buyer's insolvency: the seller may retake possession of his goods, or such of them as are found in the buyers possession, or, instead of retaking possession, the seller may elect to bring a concurrent claim against the insolvent estate, together with the general body of the creditors, all of whom rank equally.

This right to retake possession of goods, in favour of the seller, is conferred by the following Hadith.

من أدرك متاعه بعينه عند
انسان قد أفلس فهو أحق به

"If the seller finds his goods in the possession of the insolvent, he (the seller) is more entitled to retake possession thereof (in preference to the other creditors)"

As the distinguished jurist Ibn Qudama states:

فان البائع بالخيار ان شاء رجع فى السلعة وان شاء
لم يرجع و كان اَسوةللغرماء و سواء كانت السلعة
مساوية لثمنه او اقل او اكثر....

"The seller enjoys an option (upon the buyers insolvency): he may seek return of his goods, or, he may bring a concurrent claim as a member of the general body of creditors; (the right to retake possession of the goods) is available even if the value of the goods are equal to the price, or less than the price or more than the price"

(See rule 3406, Al Mughni, chapter on insolvency).

The view of the majority of the jurists may be effectively implemented by incorporating an appropriate clause in the underlying sale agreement to the effect that the seller will be entitled upon the buyer's insolvency to retake possession of the goods, which remain unsold, and are with the buyer at the time of insolvency. The seller will, by the inclusion of such a contractual term, be able to bring a claim against the insolvent estate for the return of the goods (or their value, if they are sold in the ordinary course by the trustees) in preference to other creditors.

13.

Inah Sales as a device to earn Interest

Inah (العينة) is a scheme of arrangement between buyer and seller in terms of which:

(a) the seller sells a commodity to the buyer at an agreed price in money payable on an agreed future date, and delivers the commodity to the buyer. This is a credit sale.

(b) The buyer in turn sells the same commodity back to the seller at a lower price in money which is paid in cash, and the commodity is delivered back to the seller, and remains with him.

Both transactions are disguised as sales but in substance the transaction is one of loan, with the excess (the difference between the higher price of the credit sale and the lower cash sale) constituting interest (riba). Instead of the seller giving the purchaser an interest-free loan, the scheme of arrangement involving both sales is concluded as a device to charge interest. The commodity remains with the seller, and there is an exchange of money for money, with the seller

receiving an excess constituting riba. As Ibn Taymiyyah (RA) states, the purpose of the transaction is not to trade with the commodity in question, but to provide the purchaser with cash liquidity (in the form of a loan) for the purposes of his needs.

يعنى ليس مقصود المشترى الانتفاع بالسلعة ولا
الاتجار فيها بل مقصوده دراهم لحاجته إليها

"the object of the purchaser is not to enjoy the benefits of the commodity, or, to trade therein, but his object is (to obtain) dirhams (money) to satisfy his needs"

See Fataawah of Ibn Taymiyah, vol 29. p 442

The concept of Inah is illustrated by the well known jurist Imam Saraksi (RA) as follows:

كان بكره ان يقول الرجل للرجل : أقرضنى فيقول
لا حتى أبيعك، وإنما اراد بهذا إثبات كراهية
العينة، وهو ان يبيعه ما يساوى عشرة بخمسة عشر،
ليبيعه المستقرض بعشرة، فيحصل للمقرض زيادة،
و هذا فى معنى قرض جرّ منفعة

"It was disliked that a person says to another: "give me a loan"; the lender responds "No" until I sell you a commodity. This establishes that Inah[1] was disliked; namely that the lender sells a commodity worth ten dirhams for fifteen dirhams, and the borrower sells the same commodity back to the lender for ten dirhams, with the result that the lender gains an excess, which amounts to an interest-bearing loan".
See Al Mabsut, vol 14, p36

The majority of the jurists have accordingly prohibited a scheme of arrangement based on Inah because it is in substance an interest-bearing transaction. The Shafi school has however permitted Inah irrespective of whether the price on resale is the same, or higher or lower, provided that both sales are not interconnected in the sense that the conclusion of the one is dependent on the conclusion of the other (in which event, both sales are invalid[1]). Some later Shafi'i jurists however expressed their dislike for sales based on Inah[1].

Ibn Qudamah in his Mugni states that the prohibition of Inah sales is subject to the qualification that, where the quality of the commodity has changed, then it is permissible for the resale to be at a mutually agreed price, (even if the price is lower than the first sale), because in this case, the lower price is attributed to the diminution in the quality of the commodity itself and not as instrument of earning riba[2]

لان نقص الثمن لنقص المبيع لا للتوسل الى الربا

1. See Nawawi, Rauda Al Talibeen, vol 3, p 416
2. See Al Mugni, vol 4, p51

14.

Tawarruq as an Alternative to Loan

The purpose of tawarruq is to obtain liquidity. This arrangement comprises the following separate transactions:

(a) The seller sells and the buyer purchases a commodity on credit, the price to be payable on a fixed agreed date in the future. ("the first sale credit transaction")

(b) The buyer thereafter sells the same commodity for a cash price to a third party, such cash price being a lower price (than the price payable in terms of the first sale credit transaction)

The encyclopaedia of Kuwait dealing with jurisprudence defines tawarruq as follows:

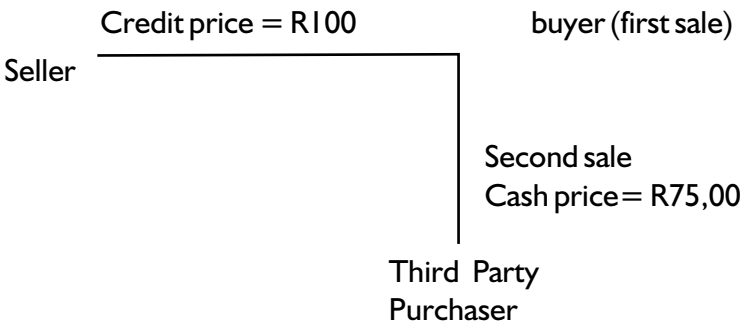
ان يشترى المرء سلعة نسيئة ثم يبيعها نقدا لغير البائع باقل مما اشتراها به ليحصل بذلك على النقد.

"a person buys a commodity on credit, thereafter he sells it for cash to a third party (other than the original seller) for a price which is lower than the price which he had paid for it. This, in order to obtain cash liquidity"

See vol 14: 147 - الموسوعة الفقهية الكويتية

The crucial distinction between Inah and tawarruq is that the buyer in tawarruq sells the commodity in the open market in terms of an arms length sale to a third party purchaser (other than the original seller). In the case of Inah, however, the parties are the same, the seller effectively retains the commodity, with the result that there is an unequal exchange of money between the same parties, the excess constituting riba.

In the case of tawarruq, the exchange of money, resulting in the excess is not between the same parties, with the result that there can be no riba or interest. This may be illustrated as follows:



The position of the four schools of jurisprudence may be summarised as follows:

1. The preferred view amongst the majority of the Hanbali jurists is that tawarruq is permissible. Ibn Taymiyyah (RA) and his student Ibn Qayyim (RA) have hovever prohibited it as interest bearing transactions.

2. The Shafi'i school has unconditionally permitted Inah. Hence, tawarruq is equally permissible.

3. The Maliki jurists appear to permit Tawarruq unconditionally.

4. The majority of the Hanafi jurists have permitted tawarruq, and have distinguished this arrangement from Inah. As Ibn Humam (RA) states:

كان يحتاج المديون فيابى المسئول ان يقرض بل
ان يبيع ما يساوى عشرة بخمسة عشرة الى اجل فيشترى
المديون و يبيعه فى السوق بعشر حالة و لا
بأس فى هذا -- فان الاجل قابله قسط من الثمن

"a debtor is in need, the proposed lender refuses to give a loan but the lender sells an article worth 10 dirhams for 15 dirhams payable on credit in the future; the debtor buys the article and sells it in the open market for 10 dirhams cash. This is permissible. The credit period (under the first sale) is in consideration for the part of the price". (Fathul Qadeer, vol 6, p 224)

In the context of Islamic banking therefore, the bank may implement an arrangement of tawarruq as follows:

(a) the bank purchases the commodity from the supplier and takes actual or constructive possession thereof. The bank should appoint its own agent, preferably an employee, but not the client for this purpose. The bank pays the supplier directly.

(b) The bank therafter, after having acquired possession, sells the commodity and delivers it to the client as the Mutawarriq. The latter assumes possession and the resultant risk thereof. The price is payable as a credit price on a fixed future date.

(c) The client as Mutawarriq thereafter sells the commodity in the open market at a lower cash price either directly or through his own agent (which must not be the bank)

In the aforegoing proposed arrangement, the identity of the agents are different. The bank appoints its own agent or broker who is different from the agent or broker appointed by the client as the Mutawarriq[1].

1. See generally, the unpublished arabic article of Mufti Taqi Usmani on Tawarruq and its application to Islamic banking.

15.

Prizes and Investment Accounts

Investment accounts of depositors in Islamic banks do not represent loans. They represent funds advanced by depositors for the purposes of being employed in Mudaarabah and Mushaarakah transactions.

The question arises whether it is permissible for the bank to give prizes to investment account holders. In other words, does the grant of such prizes amount to Qimar or Riba.

Qimar (or gambling) consists of the following elements:

1. It is a bilateral commercial transaction in which there is an exchange of consideration on both sides.

2. Each party to the transaction suspends passing of ownership of his own consideration (or money) on the occurrence of a chance event (which may or may not occur).

3. The additional consideration contemplated by this bilateral contract is dependent on an event which may or may not occur.

4. The property which is dependent on the chance event is either lost (without receipt of reciprocal consideration), to the party concerned, or, such party receives substantial return or money (if the chance event occurs), over and above what he has paid.

It follows that prizes may legitimately be given, if they are so given, as a tabarru and without exchange of money, otherwise such prizes would constitute Qimar. At the same time, such prizes should not be given as consideration for loans to avoid falling within the ambit of Riba. If prizes are given in respect of current accounts (which are loans) then this would amount to riba. This would in substance amount to a stipulated increase above the principal amount.

In respect of investment accounts, however prizes given to and received by such investment depositors does not constitute:

(a) Qimar because such prizes are pure tabarru (given without prior obligation, and for no corresponding return). The investment depositors invest their money in Mudarabah and Mushaarakah transactions for the purposes of earning profit, and the prizes are accordingly unrelated to those transactions, and have no causal connection therewith.

(b) Riba or interest. This is subject to the condition that the prizes in question do not guarantee the repayment of capital in which event the Mudarabah

or Mushaarakah would be rendered void. If the value of the prizes exceed the amount of capital, than the excess would constitute Riba. If the prizes are nominal in relation to the capital contributed by depositors (such as watches, etc), than they may be permissibly be given, provided that they are paid for from the bank's own funds (and not that of the depositors)[1].

1. See generally: the unpublished arabic article by Mufti Taqi Usmani, on the rules relating to prizes
أحكام الجوائز

16.

Debtors undertaking to pay an amount to charity upon his Default

1. The bank as creditor has a clause in its contract to the effect that, if the debtor fails to pay an instalment on due date thereof, the debtor undertakes to pay a fixed amount to charity ("the charity clause").

2. The question arises as to whether the charity clause is valid in the Shariah.

3. The distinguished jurist Mufti Taqi Usmani has expressed the view that the clause is permissible in Shariah, based on the Maliki school of jurisprudence.

See his Arabic work:

Buhus Fi Qadaayah Fiqhiyah Muaasharah pages 42 to 42 published: Maktaba Darul Uloom Karachi First Edition

4. The great Maliki jurist Allama Hattaab (RA) has dealt with the enforceability of obligations in his incisive and authoritative work:
Tahrreerul Kalaam Fi Masaail ul Iltizaam

5. The stating point in Maliki fiqh is that a person who assumes an obligation upon himself is obliged to fulfil it.

6. The obligation so assumed is enforceable as long as the debtor does not die or become insolvent.

   See: Hattaab, op cit, page 253

7. In the context of the charity clause under discussion, the obligation to pay an amount to charity is dependent on a future event: that is, non-performance by the debtor himself of his own monetary obligation due owing and payable to the creditor.

8. The Maliki jurists state that a debtor may permissibly stipulate to pay an amount to a third party, as a deterrence for his own breach of contract, if he (the debtor) were to default in payment on the stipulated future due date of payment.

9. In the case of the charity clause under consideration, the debtor effectively takes an oath ("Yameen") namely that, if he fails to pay the debt on due date, he undertakes to pay a fixed amount to charity. In other words, the debtor imposes a penalty upon himself for his own breach of contract, if this were to occur.

10. **First Objection - Riba**

This payment to charity is made on a debt (an amount of money) and therefore appears to be in the nature of Riba. The first answer is that the amount is paid by the debtor to charity, and not to the creditor, pursuant to a unilateral undertaking, in the form of a vow, taken by the debtor. The bank as the creditor derives no direct or indirect benefit from the payment, which is made to charity. The second answer is that Riba is a contractually agreed amount between creditor and debtor, in respect of and against which no consideration (recognised by Shariah) passes, such contractually agreed amount (Riba) accruing exclusively to the creditor. In this case, the creditor receives no compensation on the monetary amount of the debt in any form whatsoever, with the result that there is no Riba.

11. **Second Objection: Gharar**

This payment to charity is dependent on the occurrence of a future event, (namely, non-performance by the debtor) which may, or, may not occur. This is known as Gharar in Shariah, and is not permissible. The answer to this, is that Gharar is permissible in that class of contracts and obligations, which are known as "Tabarru". Examples of tabarru contracts are contracts of donation and suretyships. They must be distinguished from purely commercial contracts such

as sale and lease in respect of which there is a reciprocal exchange of consideration or actual performances (eg. price and thing; rental and thing).

This unilateral obligation which the debtor assumes against himself, pursuant to a vow, to pay an amount to charity is therefore a tabarru which is permissibly dependent on the occurrence or non- occurrence of a future event (breach of contract). The Muslim jurists are unanimous that a person may assume a tabarru obligation and thereby become bound or obliged to perform it.

12. **Third Objection : Penalty**

This payment to charity amounts to a penalty for non-performance by the debtor on due date. The short answer to this is that the "penalty" so called is not imposed by the bank as the creditor. It is a "penalty" (if one could term it as such) which is imposed by the debtor upon himself, for the purposes of serving as a deterrent for his own possible non-performance or breach of contract. This is why it is described as a vow (Yameen). The amount of the "penalty" so-called, is not fixed to the amount of the profit lost, in proportion to the period of the delay, but may be determined in any other manner, because it does not constitute compensation to the bank.

17.

The Prohibition of Riba is based on its cause and not rationale

The absolute prohibition of riba in the Holy Quran and Sunna, in its contemporary application, means the following:

1. any amount in excess of the principal, whether loan or debt, is treated as *riba*.

2. where money is exchanged for money, whether in a cash or credit transaction, at spot or deferred, such exchange must be at par value in equal quantities, any excess amounting to *riba*.

It is sometimes argued that the charging of a low rate of interest, or the granting of loans to huge companies, should be permissible. The basis of this argument is that such transactions do not cause injustice to either the lender or the borrower, because the Holy Quran has indentified injustice (zulm) as the perceived rationale for the prohibition of interest in the following verse:

وان تبتم فلكم رؤوس أموالكم لا تَظلمون ولا تُظلمون

"If you (the lender) repent, you are entitled to the principal (capital, but not the interest). You (must) neither commit injustice (by taking interest) nor be wronged (by taking less than your due capital)

This argument is misconceived because it fails to distinguish between the cause *(illah*) of a prohibition, and its perceived rationale (*hikma*).

The established principle of Islamic jurisprudence is that the application of a rule of the shariah is dependent on the existence (or, non existence) of the cause underlying the relevant transaction, and not its perceived rationale. Take the following examples:

a) *Shufa* (الشفعة) is a special kind of right of pre-emption which is available to an immediate neighbour, and to a co-owner of immovable property which is owned in undivided shares. If a co-owner of immovable property, or, the owner of immovable property, sells his undivided share, or, the property itself (as the case may be) to a third party outsider, then, the remaining co-owner, or the immediate neighbour has a right of pre-emption to acquire the property at the price agreed between the seller and the third party outsider. The rationale for the granting of the right of pre-emption is the avoidance of harm or injury at the instance of the third party purchaser.

Despite such rationale, and whether or not the potential for injury exists, the right of pre-emption in the form of shufa remains available, if the cause of entitlement to the right exists, namely, being an immediate neighbour, or, a co-owner. This means that a judge must enforce the right of pre-emption in the form of *shufa*, in favour of the co-owner or the immediate neighbour, even if the potential for injury (the rationale) is absent in a particular case. Conversely, the judge cannot grant the right of pre-emption to a person other than the immediate neighbour or co-owner, simply because the rationale is present (the potential for injury exists) but the cause of entitlement is absent (being an immediate neighbour or co-owner).

b) A person who is on a journey during the month of ramadaan is entitled not to fast. The cause (illa) of the entitlement is the journey itself, although he or she suffers no hardship or difficulty (which is the perceived rationale for the permissibility of not fasting). On the other hand, a normal person employed at his place of residence in difficult circumstances is obliged to fast, although he or she may experience hardship and difficulty.

Similarly, in the case of riba, the cause of its prohibition is the contractual stipulation of any excess amount over and above the principal or the capital, irrespective of whether or not the charge of interest in the particular case results in injustice or

not. The prohibition comes into force as soon as any excess is charged above the principal, the perceived rationale being irrelevant. In short, therefore, the application of a rule of shariah is premised on its cause, which is capable of precise definition, and not on its perceived rationale (whose application always remains open to dispute). What is just or unjust in a particular case may give rise to differences of opinion.

18.

The difference between Dain (debt) and Ain (thing)

The word dain has been defined as follows :

وصف شرعي في الذمّة يظهر أثره عند المطالبة

"a legal qualitative obligation which becomes effective at the time of demand"
(fathal qadeer, on hawalah, vol 6, p 346)

In article 158 of the *Majallah,* the word *dain* is defined as

الدين ما يثبت في الذمّة كمقدار من الدراهم

"dain is a debt or obligation, such as the payment of a quantity of *dirhams* incurred by a person as an obligation"

In essence, therefore, dain refers to a debt or obligation incurred by a person. This obligation takes various forms in the context of commercial transactions, *(muawada)*, such as ***interalia*** the following:

a) in an ordinary contract of sale, the price (money) is a debt (*dain*) incurred by the purchaser. Even if the agreed price say (R100 000) has been separately set aside or identified or pin-pointed, the obligation to pay remains a debt, with the result that the purchaser is obliged to pay the equivalent amount, and not the sum so set aside. The reason for this is that money is regarded simply as a means of exchange, with no intrinsic utility, with the result that its identification or non-identification at the time of sale is irrelevant. This rule is expressed in the following terms:

لا يتعين الثمن في العقد

"the price in a contract cannot be pin-pointed"
[see article 243 of the *Majallah*]

b) in the special contract of salam, where the price is paid upfront at spot, the seller (*muslam ilaih*) has an obligation (*dain*) to deliver the specified commodity on the agreed future date. This is described as:

عقد على مبيع في الذمّة

"a contract in terms of which the seller incurs a debt or obligation to deliver a thing"

(c) In the contract of *istisna*, where the seller manufactures a commodity in accordance with agreed specifications, such seller incurs a debt or obligation to deliver the agreed specified commodity on the date of delivery.

d) in a contract of lease (*ijarah*), the lessee incurs an obligation or debt to pay the agreed rental on the stipulated date.

A thing (*ain*), on the other hand, refers to a right to a specific agreed thing or commodity. In a normal contract of sale, the purchaser is entitled to the specified thing or commodity. In a contract of lease, the tenant is entitled to the use of a specified thing or property. In such cases, the right effectively attaches to the thing, and does not constitute a debt or obligation on the part of the seller or lessor. This has been described in the following terms:

هذا حق تعلّق بالعين لا بالذمّة

"these rights attach to the thing itself, and do not constitute debts or obligations (incurred by a contracting party such as the seller or lessor) (see: *Mugni*, vol 4, rule 3249, on *salam*)

It follows from the aforegoing that a debt is discharged by payment (or, delivery of the agreed thing in the case of *salam* and *Istisna*). A monetary debt may also be waived. This is expressed as follows:

لا يسقط إلا بالأداء أو الإبراء

"a debt is not discharged except through payment or waiver thereof".
[See: Sharh Al Majallah, Attasi, vol 2, p 23]

The distinction between *dain* (debt) and *ain* (thing) has far-reaching consequences. If the thing sold in a normal contract of sale is destroyed, in the hands of the seller, then the contract becomes void. If the price however is lost in the hands of the buyer, the buyer is still obliged to pay the price because the price (in the form of money) is a debt due by the buyer. Similarly, as a general rule, a valid debt (*dain*) may be guaranteed or transferred by assignment (*hawala*).

كل دين تصح الكفالة به تصح الحوالة

"Every debt in respect of which a guarantee is permissible, may also validly be transferred by *hawala* assignment"
[see article 688 of the Majalla]

Finally, monetary debt (*dain*) once fixed at the time of the contract remains fixed, as an obligation, and cannot be increased or decreased thereafter. The price in a contract of sale, or, rental in a contract of lease, once agreed at the time of the contract is converted to a *dain* or debt. Any increase thereon subsequently will amount to *riba*, because there is no corresponding consideration for such increase.

19.

Tabarru and Muawadah (Benevolent and Commercial Contracts)

The distinction between benevolent contracts (*tabarru*) and commercial contracts (*muawadah*) is critically important in Islamic jurisprudence.

The primary purpose underlying a contract of *tabarru* is benevolence, and not commercial gain. It is gratuitous, the grantor seeking no commercial return or quid pro quo. Examples of tabarru contracts are donations, loans, *wasiyah* (legacies) and *wakf*. The concept of benevolence underlying a *tabarru* contract appears from the following passage:

المتبرع من يقصد الإحسان إلى الغير من غير أن يقصد
دفع الضرر عن نفسه أصلا

> "the grantor or donor intends to do good (ihsan) to another, without intending to avoid prejudice to himself"
> [see Fathul Qadeer - chapter on *hawalah*]

The primary purpose underlying commercial contracts, on the other hand, is commercial gain or return. They are described as contracts of *muawadah* in which there is a reciprocal exchange of consideration. Examples of such commercial contracts are sale and lease.

The primary distinction between contracts of *tabarru* and *muawadah* is the effect of *gharar* on each category of contract. *Gharar* which is dealt with separately means in essence suspending a contract on an uncertain chance event, which may or may not occur.

The general rule is that gharar renders a commercial contract of *muawadah* void. *Gharar*, however, according to the *maliki* view, has no effect on a benevolent contract of *tabarru*. This distinction may be illustrated by the following examples.

(a) a person (donor) donates to another (donee) the fruits of his trees which will mature next spring. If the fruits mature, the donee benefits. If the fruits do not mature, the donee suffers no loss, because he has paid nothing. The contract of donation does not give rise to any dispute in this case.

(b) In contrast to (a), if a person (seller) sells to another (buyer) for an agreed specified price, the fruits of his trees which will mature next spring, the contract of sale is void because of *gharar* (or uncertainty of whether or not the fruits will mature).

> If the fruits do not mature, the buyer suffers a loss, leading to dispute and acrimony between the contracting parties.

Modern commercial contracts of insurance are primarily invalid in Islamic Law because they are commercial contracts of gain which are vitiated by *gharar*. In terms of the relevant insurance contract, a premium is paid in return for an indemnity which is payable by the insurer upon the occurrence of a chance event (which may or may not occur). The Islamic alternative is *takafol* which in its current application is based on the *tabarru* model.

Contracts of *tabarru* such as donations and loans are generally completed by possession. In a contract of donation, ownership of the donated thing passes from donor to donee upon possession thereof by the donee. By contrast, in a contract of sale, ownership passes from seller to buyer upon conclusion of the sale, with risk in the commodity passing upon possession by the buyer.

An invalid (*fasid*) condition in a contract of sale or other commercial contract generally renders the whole contract void. By contrast, an invalid condition in a *tabarru* contract of donation or loan is severable from the contract, with the result that the contract remains valid, the impugned condition being invalid. This principle of severability appears from the following passage:

و الأصل أن كل عقد من شرطه القبض فان الشرط
لا يفسده كالهبة و الرهن

> "the original principle in respect of every contract in terms of which possession is a condition (for its completion), is that the invalid condition does not render the contract void, (but is severable therefrom), such as donation and pledge".
> [see: *Atasi, Sharal Majallah,* volume 3, article 854]

If a donor donates a car on condition that the donee is prohibited from selling the car, the donation is valid but the restrictive condition is void. Similarly, if a lender lends money with an interest stipulation, the loan is valid but the interest stipulation is void. On the other hand, if the seller stipulates that the buyer is absolutely prohibited from reselling the article, the whole sale contract is void, because the contract is a commercial contract (*muawadah*).

Finally, it must be noted that riba can only be realised in commercial contracts of muawadah, and not in contracts of *tabarru*, which are non-profit making. This appears from the follwing statement of *Allama Aini* (RA):

ليس الربا إلا بمال يملك بالعقد من غير عوض وهو يعمل في المعاوضات دون التبرعات

"interest in only constituted in the form of excess property which is acquired, as a result of a contract, without a corresponding consideration in exchange (for such interest, or excess) and this applies to contracts of *muawadah*, and not to contracts of *tabarru*".

[see *Binaayah*, commentary on Hidayah, chapter on sale, p 258, *fasid* or void conditions)

20.

Gharar (Uncertainty of Outcome)

In the light of the difference between commercial (*muawadah*) and benevolent (*tabarru*) contracts, the concept of *gharar* is most important. As stated, gharar renders a commercial contract of gain (*muawadah*) void. The concept of *gharar* is examined in more detail below.

> The great Hanafi jurist Allama Saraksi (RA) defines gharar as follows:
>
> الغرر ما يكون مستور العاقبة
>
> "*gharar* means uncertainty of outcome or result" [see *Mabsut* vol 13:194, quoted by Sheikh Professor Siddiq Muhammad Al Amin Alldarir in his well known work on *gharar* and its effects on contracts, at page 48)".
>
> *Gharar* which is a broad concept may be classified as follows:

1. uncertainty of the thing or price or term of payment in a contract of sale. For example, the seller sells his car at a price to be fixed by him (the seller). In this case, the quantum of the price to be fixed by the seller is not known at the time of the contract, and is dependent on the volition of the seller, which is uncertain at the time of contract.

2. the subject matter of the sale is not capable of delivery to the buyer. For example, the sale of birds in the air, or, fish in the sea.

3. the conclusion of a sale subject to a suspensive condition or other contingency which may or may not occur. For example, A sells his house to B on condition that B is granted a loan by a certain financial institution. It is uncertain whether the loan will be granted or not by the third party financial institution.

(4) the transfer of ownership is made contingent on a chance event which may or may not occur. This is described as

تعليق التمليك على الخطر

"the suspending of ownership on a chance event (which may or may not occur)". (examples, are gambling and wagering contracts of all kinds)".

The aforegoing classification of *gharar,* in the light of Allama Saraksi's definition, covers both situations: uncertainty of whether the contingent event will occur or not; and uncertainty of quantum or amount *(majhul)*.

A good example of *gharar* from early times is the contract of friendship or clientage concluded between a new muslim and another (muslim). The new muslim had no relatives who were entitled to inherit from him. In terms of the contract known as *muwalah* (مأوالاة), each party agreed to inherit from the other, depending upon who died first. If A died first, B, as the other contracting party, would inherit from A. If A sold his right to inherit from B, to a third party C, the contract of sale was void. The reason for this was that, whilst A received the agreed price for the sale of the right to inherit (the price being certain), the entitlement on the part of the third party C to receive the potential inheritance was uncertain: this depended on uncertain future events as to who died first. If A predeceased B, C as a third party purchaser would lose the right to inherit. Similarly, C as the third party purchaser would lose the right to inherit, if C predeceased A (the seller of the right). Because of *interalia* the existence of *gharar* in the sale transaction, the Holy Prophet (SAW) forbade the transaction in the following hadis:

نهى عن بيع الولاء و هبته

"the Holy Prophet forbade the sale of *wala* (right to inherit) or its donation".

[see Muslim: *Hadis* number 3672]

21.

Suspensive Sales

A contract of sale takes effect immediately upon conclusion thereof. Ownership of the commodity passes immediately from seller to buyer upon conclusion of the sale. The risk in a movable commodity passes from the seller to the buyer upon possession thereof, actual or constructive, by the buyer. In a cash sale, the seller is entitled to withhold delivery and hold the thing against payment of the price. The thing sold is the subject matter of the sale. If the thing is destroyed in the hands of the seller, prior to delivery to the buyer, the contract is rendered void. The buyer is not entitled to sell or lease a movable thing to a third party until (the buyer) has taken actual or constructive possession of the thing.

If however the contract of sale contains a condition which suspends its operation upon an event which may or may not occur, the sale is void. In this case, the operation of the whole contract is suspended upon the occurrence or non occurrence of the uncertain event, thereby amounting to *gharar* which is prohibited expressly by the Holy Prophet (SAW). The rationale suggested by Professor Sheikh Siddiq Amin Dharir for the prohibition of suspensive conditions is

that they affect contractual assent. Because the contract itself is suspended to a future date, the resultant time lapse could lead to a variation in the price of the thing, which, in the interim, could have increased or decreased in value. He states as follows:

إن التعليق قد يؤدّي إلى أكل المال بالباطل في حال وجود العقد
وذلك لأن العقد سيوجد
في وقت مستقبل لا يعلم العاقدان كيف يكون فيه
حال السلعة و قيمتها

> "A suspensive condition could lead to the unlawful appropriation of property at the time when the contract comes into existence. This is so because (when) the contract does come into existence on a future date, the contracting parties do not know the state of the subject matter or its value (which may increase or decrease).
>
> [see his work on *Gharar* and its effects on contracts at p 165]

A common example of a suspensive condition is the following: A sells to B his immovable property on condition that B obtains a loan for an agreed amount from a financial institution - an event which may or may not occur.

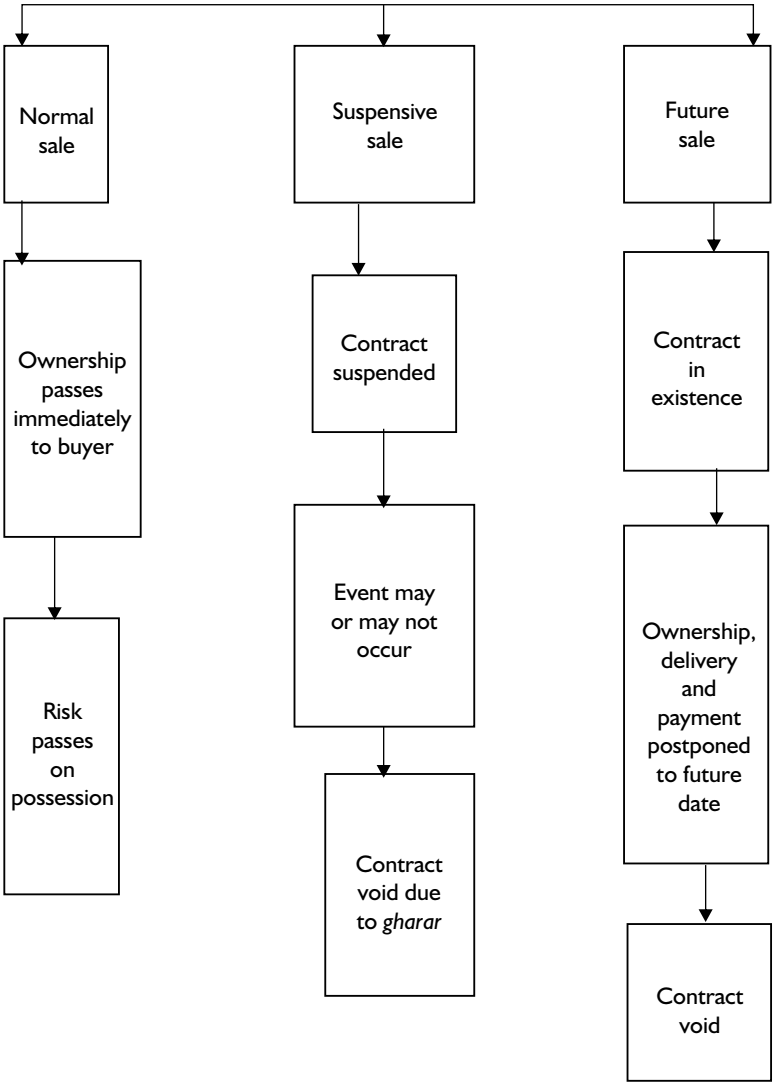
As opposed to a suspensive sale (which is dependent on an uncertain event), a future sale is ascribed to a future date. For example, A undertakes on 1 January to sell his house to B for an agreed price on the 1 February. Such a future sale, whose consequences (such as passing ownership) are postponed to a future date is invalid. In this case also, the nature of the thing could have materially changed, or, the price could have increased or decreased in the interim, thereby affecting contractual assent. Viewed from another perspective, an agreement to sell a thing and pay the price thereof against delivery, on a future date, gives rise to the exchange of two future obligations - the obligation to sell and deliver in exchange for the obligation to pay, both sets of obligations to occur on a future date. Such an exchange of the future obligations is prohibited. It is known as:

بيع الكالئ بالكالئ

> "the sale of a future obligation (debt) in exchange for a future obligation (debt)".

In summary therefore the overwhelming majority of jurists (*jumhur*) regard suspensive and future sales as invalid. The parties must conclude a fresh valid sale, through offer and acceptance, on the future date or upon the occurrence of the contingent event.

The aforegoing may be illustrated as follows:


Normal sale
Suspensive sale
Future sale
Ownership passes immediately to buyer
Contract suspended
Contract in existence
Risk passes on possession
Event may or may not occur
Ownership, delivery and payment postponed to future date
Contract void due to *gharar*
Contract void

22.

Risk and Profit

The Holy Prophet (SAW) has stated in a well known *hadith*:

ولا ربح ما لم يضمن

"the Holy Prophet (SAW) forbade (the earning of) a profit or gain in respect of a transaction in which a risk had not been assumed".

The important principle is that a person cannot make a profit unless he has assumed a corresponding risk. This principle, which is foundational to commercial transactions of all classes, may be illustrated by the following examples:

1. A sells a movable commodity to B. B, as the purchaser, prior to possession thereof, sells the commodity to a third party C at a profit of say R10 000. B is not entitled to the profit because B has not taken actual or constructive possession of the movable commodity. In other words, B has not assumed the risk (*daman*) of destruction of the movable commodity. B's entitlement to the profit is

premised upon B assuming the risk of destruction which is transferred upon possession from A to B. The profit on the resale is earned in lieu of the risk.

لان المنفعة بمقابلة الضمان

2. A lends B the sum of R100 000. Once B takes possession of this amount, the risk in the loan passes from A (lender) to B, (borrower). A therefore cannot charge interest on the loan because this would constitute a profit in respect of which A (as lender) has assumed no risk. Conversely, B as borrower is entitled to employ the loan in legitimate trading, and thereby earn a profit thereon. If the loan is lost in the hands of B (as borrower), B is still obliged to repay the loan to A because the risk had passed to B upon possession of the loan by B.

3. There is a difference of opinion on whether a lessee is permitted to sublet the premises at a higher rental than that paid by the lessee to the owner under the head lease. Imam Abu Hanifah (RA) does not permit a sub-lease at a higher rental because the excess profit is earned in the situation where the sub-lessor does not assume a risk. If the sub-lessor had effected improvements to the premises, then the excess would be in lieu thereof and therefore permissible. [see Mugni, Rule 4215, vol 6, p 62]

(4) the producer of an article subcontracts the work to another at a lower price. The producer is entitled to

the profit, being the difference between the main contract and the sub-contract. The reason for this is that the producer has assumed the risk of delivering the finished product in terms of agreed specifications to the buyer under the main contract. The entitlement to the excess profit results from the assumption of the risk itself.

ولا سبب لاستحقاق الفضل إلا الضمان

"there is no cause for entitlement to the surplus except the assumption of risk."
[see: *Badai*, Imam Khasani (RA), vol 5, p 83]

5. The buyer of a motor vehicle returns the vehicle to the seller because of defects. The buyer is entitled to the rental earned on the vehicle during his use and possession, and whilst unaware of the defects. He is not obliged to account to the seller. The reason for this is that the buyer had assumed the risk of destruction after he had taken possession of the vehicle. If the vehicle in such event had been destroyed, the loss would have fallen on the buyer.

Finally, it is in this context also significant to bear in mind the well known *hadis*:

الخراج بالضمان

"Entitlement to profits and benefits (of a thing) are as a consequence of the assumption of the risk in the thing".

This *hadis* is also regarded as a well known legal maxim. The assumption of the risk in a thing means that if the thing were destroyed, the consequent loss would be borne by the person who had assumed the risk. In lieu thereof, the person is entitled to the profits and benefits. In this sense, it is said that the thing has passed into the risk of such person.

23.

Permissible and Impermissible Contractual Terms

As stated previously, a contract of sale results in the operation of its normal incidents or consequences, such as the transfer of ownership of the thing from the seller to the buyer; the obligation of the seller to deliver the article to the purchaser against the payment of the price.

The critical issue however is: what categories of contractual terms may be permissibly included in a contract of sale?

The muslim jurists are unanimous that a condition or contractual term which is contrary to the very essence of the contract itself, will render the whole contract null and void. Examples of contractual stipulations which will render the whole contract void are as follows:

(a) the seller stipulates absolutely that the buyer cannot dispose of the thing for the buyer's benefit.

(b) the lessor stipulates that the lessee is precluded from enjoying the benefits of the leased property.

(c) a contractual stipulation that ownership in the thing sold shall not pass to the buyer until payment of the full price.

Contractual stipulations, on the other hand, which are either consistent with the contract, or, supported by commercial usage are permissible. For example, a seller sells a thing on condition that the buyer provides a defined pledge, or, that the buyer provides a defined guarantee or personal suretyship, failing which, the seller may cancel the contract. Such terms secure payment of the price as a normal contractual incident of the sale.

Similarly, a sale containing a condition supported by commercial usage is permissible, although the condition is not consistent with the contract itself. Such conditions based on custom (URF) must off course not be contrary to an express text (Nass) of the Holy Quran and Sunna. Article 188 of the Majallah (Ottoman Code based on *Hanafi* jurisprudence) states as follows:

البيع بشرط متعارف يعني الشرط المرعي في عرف البلدة صحيح و الشرط معتبر

> "A sale subject to a condition recognised by the commercial usage of a specific city or area is valid; and the condition itself is competent".

A common example of a customary term is a sale subject to the condition that, the seller would service the article free of charge for an agreed period.

The problem, however, arises in respect of contractual stipulations which are inserted for the benefit of the one contracting party, and not the other. Such conditions fall outside the normal contractual incidents, and are not supported by trade usage but confer a defined benefit to one of the contracting parties. Examples of such contractual stipulations inserted for the benefit of the one contracting party are as follows:

(i) a contractual term inserted for the benefit of the seller to the effect that the buyer in a credit sale cannot sell the property until the full purchase price is paid.

(ii) a contractual term inserted for the benefit of the seller to the effect that the seller may reside in the residential property, sold under the agreement, for an agreed period.

The *Hanafi* school does not permit contractual stipulations (outside normal contractual incidents, which are not supported by trade custom) for the exclusive benefit of one party, either because such additional stipulations amount to riba, or, are otherwise hit by the principle of *safqa fi safqa*. (one contract tied or linked with another, such as sale linked with a lease). Imam Khaasani (RA) gives the following reason

for the prohibition of a contractual term for the exclusive benefit of a contracting party:

لأنه زيادة منفعة مشروطة في البيع يكون ربا لأنها
زيادة لا يقابلها عوض في عقد البيع
وهو تفسير الربا و البيع الذي فيه الربا فاسد أو
فيه شبهة الربا و انها مفسدة للبيع كحقيقة
الربا

> "a sale containing a stipulation for the benefit of one contracting party only is invalid because it contains an additional contractually stipulated benefit to one party which amounts to *riba* - because the excess contractually stipulated benefit is not represented by a corresponding consideration in the contract itself which is the meaning of *riba* - a sale containing *riba* is invalid, or a sale which is doubtful of *riba* is equally invalid."
> [see: Badai, volume 5, p 169 173]

The position of the *Shafei* school is similar to the *Hanafi* school in this regard. The *Shafei* jurists have similarly prohibited contractual stipulations inserted for the benefit of the one contracting party only. For example, they have prohibited contractual stipulations such as the following:

1. the sale of crops on condition that the seller reaps the

same.

2. the sale of cloth on condition that the seller sews the same.

3. the sale of a house on condition that the buyer lends the seller an agreed amount.

The *Maliki* school however has adopted an extremely broad approach to contractual stipulations or terms, which are not contrary to the every essence of the contract itself. They have gone much further than the *Hanafi* and *Shafei* schools in developing the law in this field. The original position of the *Maliki* school is that a contractual stipulation (which is not contrary to the essence of the contract) is permissible (*mubah*). Invalid conditions are treated as exceptions to the general rule.

Accordingly, in terms of the *Maliki* school, every contractual term or stipulation which confers a rational benefit to only one contracting party is permissible, provided that the term is not contrary to the very essence of the contract itself. On this basis, the *Maliki* jurists give the following examples of contractual terms for the benefit of one party, which may be permissibly incorporated in the contract:

1.1. the seller stipulates that the buyer must utilise the property sold under the agreement to build a mosque or the purposes of a wakf.

1.2. the seller stipulates that the buyer cannot dispose of the thing sold under the agreement until the whole purchase price in a credit sale is paid.

1.3. the seller stipulates that he is entitled to reside in the property sold under the agreement for an agreed period.

In short, under the *Maliki* school, a contractual term is only invalid (*fasid*) in two specific situations, as stated by the great *Maliki* jurist *Alhattab* in the following passage:

لا يكون الشرط مفسدا إلا في إحدى الحالتين:
مثل أن يبيع شيئا بشرط أن, إما أن يكون الشرط مناقضا للعقد
لا يتصرف فيه أو يؤجر
شيئا بشرط أن لاينتفع به,
و إما أن يكون الشرط يخل بالثمن بان يزيده أو ينقصه
إلى قدر غير معلوم

"A contractual term is only invalid in the following two situations.

> "A contractual term is only invalid in the following two situations:
>
> **First**, where the contractual term is contrary to the essence of the contract itself; for example, to sell a thing on condition that the buyer is absolutely prohibited from disposing of it; or to lease a thing on condition that the lessee is prohibited from enjoying its benefits.

> **Second**, where the contractual term impacts adversely on the price by either increasing or decreasing it to an amount which is not determinable…."
> [see *Al Hattab: Mawahib al Jalil*, vol 4 p373]

The approach of the Hanbali school is similar to the Maliki school. The Hanbali school has categorised conditions as follows:

1. normal incidents which flow from a contract, such as the passing of ownership upon conclusion of the sale itself. These apply whether or not incorporated in the contract by operation of law.

2. contractual stipulations which are advantageous or beneficial to the contracting parties, such as the requirement of a pledge or the fixing of terms of payment. Such conditions are valid and enforceable.

3. Contractual terms which fall outside the normal contractual incidents, are not consistent, but are nevertheless not contrary to the essence of the contract itself. These conditions confer a rational benefit to the one contracting party, and not the other such as the sale of a house on condition that the seller may reside therein for one year. Such contractual terms are permissible.
   [See generally, Sharh al Kabir, vol 4, p 54 to 56 and also Mugni, vol 4, p 309]

24.

Permissible and Impermissible Suretyships and Guarantees

The contract of suretyship (*kafala*) is well known. It is essentially a benevolent contract in terms of which the surety undertakes liability for a valid principal obligation or debt to the creditor. The *Hanafi* jurists have defined a suretyship as follows:

ضم الذمّة إلى الذمّة في المطالبة

> "the joining of the liability (of the surety) with the principal liability (of the debtor) in connection with the creditor's right to demand payment or exact performance"
> [see: *Hidayah*, chapter on suretyship]

The critical question that arises in the context of contemporary commercial transactions is: in what categories of obligations or property is a contract of suretyship (*kafala*) valid according to the shariah?

The starting point is that a suretyship is valid in respect of all valid debts (الديون الصحيحة) owed by a principal debtor to a creditor. Such debts are properly discharged by payment

to the creditor or by way of a valid waiver or release.

ما لا يسقط إلا بالأداء أو الإبراء

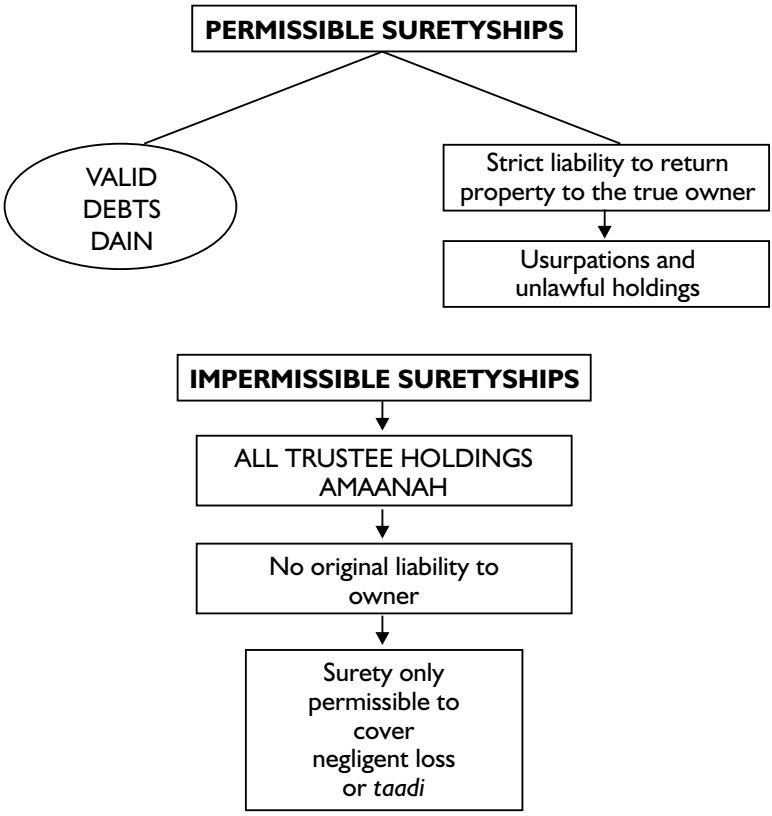
A suretyship however is not valid in respect of all classes of property held in trust, such as property held by a tenant, partner, depositary or borrower of a thing. These categories of holders are not liable for loss to the owner, unless they commit misconduct or negligence. (تعدّي). It follows that in such cases a suretyship may be procured by the owner to cover a loss arising from negligence or misconduct which falls within the ambit of *taddi*, (تعدّي) only.

Similarly, a suretyship is not valid in respect of guaranteeing property sold under an agreement of sale prior to possession by the purchaser. For example, a surety binds himself to the purchaser in the following terms: "I undertake to provide a substitute, if the property is destroyed." The reason for this is that the property is guaranteed against the price, in the sense that if the property were destroyed, prior to possession by the buyer, the sale is void, and the price falls away. If the price has been paid, the seller is obliged to refund it. This is technically described as: مضمون بغيره

A suretyship is valid in respect of property whose return to the true owner is obligatory on the holder of the property. A common example is an unlawful holder, or, what is described as usurped property. (magsub). In this case, the usurper of property is obliged to return the thing itself, or failing that, its value. It follows that the true owner may procure a surety

who guarantees the return of the thing or its value.

The aforegoing may be illustrated by the following diagrams:



Finally, in the context of suretyships and guarantees, it must be noted that the guaranteeing of a loss is not permissible. The reason for this is that a valid principal debt or obligation may be guaranteed by a third party. A loss per se does not create a liability on any person. The great *Hanafi* jurist *Ibn Humam (RA)* states as follows:

و ضمان الخسران باطل لان الضمان لا يكون إلا بمضمو
ن والخسران غير مضمون على
أحد حتى لو قال بايع في السوق على
أن كل خسران يلحقك فعليّ لا يصح

"the guaranteeing of a loss is void, because a guarantee may only be given in respect of property which creates a liability ("mudmun"). A loss does not attract a liability on any person. If a person says to a seller:

> "I will compensate you for all loss suffered by you", this is not permissible".
> [see: *Fath al Qadeer*, chapter on *kafala*]

25.

Trading in Rights

The purpose of this chapter is to briefly examine what categories of rights are recognised by the *shariah* and whether such rights are tradable or disposable. In order to understand this, rights may be classified as follows:

1. **Necessary defensive rights:** الحقوق الضرورية
   These rights are established by the shariah in order to avoid prejudice to the holder of the right. For example, the right of defined pre-emption (sufa) is conferred upon the immediate neighbour, and the co-owner of undivided shares in immovable property. The holder of the right of defined pre-emption is entitled to acquire the property or the undivided share (as the case may be) from the purchaser, in order to avoid prejudice to himself. This right of pre-emption is not an original right (contractually acquired) but is conferred by the shariah to avoid prejudice to the holder of the right. It follows that the right of pre-emption cannot be validly sold or compromised for a consideration.

The right may however be waived or abandoned. Such waiver or voluntary renunciation of the right would indicate that the holder of the right suffers no prejudice, with the result that he is not entitled to any consideration, whether by way of sale or compromise.

2. **Original Personal Rights** الحقوق الأصلية

These are rights which are granted to the holder as original rights, and are not established to avoid prejudice to the holder of the right. Examples of such rights are the rights of qisas, inheritance and nikah (marriage). These rights are conferred specifically on the holder of the right and cannot be disposed off by way of sale. Such rights may however be compromised (sulh) for a consideration. The right to inherit (which is acquired after the death of the deceased) cannot be sold but may be compromised for an amount. The right to retain the wife in marriage cannot be sold but may be compromised through a khula (where the wife pays agreed compensation for a divorce). In the case of inheritance, the "right" to inherit only matures into an enforceable right upon the death of the deceased. In his lifetime, there is at best a hope or expectation which cannot be traded in any manner whatsoever.

3. **Customary rights** الحقوق العرفية

These are rights which are established by custom. They cover the sale of benefits per se which have a

commercial value, including the sale of intellectual property of all classes. Similarly, they cover trading in servitudes, such as right of way and the right to draw water. In this regard, the Shafei and Hanbali schools adopt a broad approach by extending the definition of sale to cover benefits (as opposed to tangible property). The preferred Hanafi view is that the sale of rights attached to tangible property (as opposed to the sale of pure rights) is permissible. On the Hanafei view, the sale of goodwill (not as a pure right) but as part of a going concern business is attached to tangibles, and is therefore permissible.

4. **Renunciation of rights by Compromise (and not sale)**

These rights cover a waiver of an established right for an amount by way of compromise. The jurists have given two examples in this regard.

4.1. A person renounces his right to continue in a post in favour of another, and charges an amount for such waiver by way of compromise. This is described as:

نزول عن الوظائف بالمال

4.2. A lessee renounces his rights under the lease in favour of a third party who steps into his shoes for the outstanding period of the lease for an amount. This compromise of the right to lease is described as:

تنازل عن حق الاستئجار بعوض

Finally, custom and commercial usage may characterise rights and benefits as constituting tradable property (for example, the sale of electricity). In this regard, the great jurist Ibn Abideen (RA) states as follows:

إن للعرف مجالا في إدراج بعض الحقوق
في الأموال فان المالية تثبت بتمويل الناس

"Custom enjoys a wide scope in characterising rights with the status of property. Property becomes established (and is regarded as property) through established commercial usage."

(see the article on the sale of pure rights, Mufti Taqi Usmani, *Buhus Fi Qadayah Fiqhiyah Muasarah*, page 116, and generally from pages 73 to p 125)

Other Publications by the Author

1. The Islamic Law of Succession
2. The Basic Concepts of the Islamic Law of Divorce
3. The Rules of Hajj and Umrah
4. The Rules of Itikaaf (Translation: Mufti Taqi Usmani)
5. What is Christianity? (Translation: Mufti Taqi Usmani)
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8. Selected Essays in Islamic Law
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   (Compiled & edited: Mufti Taqi Usmani)