

A Critical Review of Islamic Deposit and Financing Transactions

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This paper focuses on issues of form and substance in Islamic deposit and financing transactions. It critically analyses the deposit and financing products of Islamic banks. It argues that a transaction establishes a certain contractual relationship between the parties and entitles them to certain rights and obligations. This paper argues that issues related to substance in transactions are directly concerned with the rights and obligations of the contracting parties. A transaction that only in form complies with the Shari'ah but not in substance has a different set of consequences for the contracting parties. It may entitle the contracting parties to a set of rights and obligations different from the ones that are intended by the Shari'ah. The paper also relates Islamic deposit and financing transactions to the objectives (maqasid) of Shari'ah and argues that wealth should benefit not only its owner but also the society. The paper concludes that Islamic deposit and financing transactions should entitle the parties to a set of rights and obligations assigned to them by the Islamic law and should become a means for achieving the objectives of Shari'ah.

Islamic banking and Finance

Introduction

This paper begins with a discussion of deposit and financing products of Islamic banks. It discusses the arguments made for and against the Islamic deposit and financing products. It critically examines the comparisons made between Islamic deposit and financial transactions and their conventional counterparts. It next discusses the formation of a contract, the intention of the contracting parties, the effect or result of a certain contract, and its ensuing rights and obligations for the parties. It argues that the substance of a contract refers to its purpose and the ensuing rights and obligations that result from it. It concludes that an Islamic deposit and financing contract should entitle the parties to the rights and obligations assigned to them by *Shari'ah*. Depriving the parties of their rights and obligations will take away the substance from the contract and

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render it similar to its conventional counterpart and a mere change of name is not sufficient to render it *Shari'ah* compliant.

Islamic Deposit and Financing Transactions

A conventional bank takes deposits from its customers as loans for a certain rate of interest and channels them to others as loans for a higher rate of interest. The difference between the two rates of interests is a 'profit' for the bank. The bank acts as an intermediary and the depositors and the customers have no direct link with each other. The *raison d'être* for the existence of Islamic banks is the avoidance of interest. An Islamic bank therefore has to use other alternative contracts both on deposit and financing sides that would replace the interest-based loan contract. They have to take money from the depositors and channel them to the customers in permissible ways that would comply with the *Shari'ah*. There are various contracts that enable Islamic banks to offer alternative *Shari'ah* compliant investment opportunities to its customers and customers. It is therefore necessary to briefly discuss some of these contracts and see how Islamic banks use them in practice.

Islamic banks take deposits from the depositors based on *wadi'ah* and *mudharabah* contracts. In a *wadi'ah* contract the bank acts as a safe keeper of the fund. The bank seeks the depositors' permission to use the fund for its *Shari'ah* compliant investment activities. The bank guarantees that the depositors can withdraw their money at anytime upon demand. The bank in its discretion gives some additional amount over and above the deposit to the depositors as gift (*hibah*). Under the *mudharabah* concept the depositors become the capital providers or investors (*sahib al-mal*) and the bank acts as an entrepreneur or manger (*mudharib*). Both the fund providers and the bank agree on a certain percentage for the division of profit and the fund providers alone take the risk of a possible loss. The bank as a *mudharib* may use the *mudharabah* fund for its financing activities or channel the fund to others. The banks also take fund from the depositors based on *tawarruq* commodity *murabahah*. The customer purchases a certain commodity from a supplier in cash and sells it to the bank for a deferred higher price payable in certain agreed upon time or by instalments. The bank then sells the commodity to another supplier for cash. In this way the bank gets the cash, and it has to return the price of the commodity which includes a profit to the customer.

On the investment side Islamic banks instead of providing interest based loans use sale, lease, and partnership contracts. The contract of sale and its varieties such as *murabahah* and deferred sale (*Bay Bi-thaman Ajil-BBA*) are widely used as alternatives to conventional mortgages and other interest-based conventional products. In a conventional mortgage the bank provides the customer with a loan in order to finance house purchases. The customer would repay the loan plus interest by instalments in a certain period. The amount of interest the customer would pay depends on the length of the financing period and the fluctuations in the interest rate. Meanwhile the house is mortgaged with the bank. In a *murabahah* or BBA contract a certain property is sold for its purchase price plus a specified mark-up agreed upon. Usually a customer will promise (*wa'ad*) that if the bank purchases a certain well-defined asset such as a house the customer will purchase it from the bank for a certain agreed-upon

price. The bank while relying on the promise proceeds to purchase the house and then sells it to the customer in accordance with the terms and conditions of the promise. For houses under construction an Islamic bank may also use *istisna'* contract where a bank purchases a house from the developer in cash and then sell it based on *istisna* contract to a customer for a deferred price. In Malaysia an Islamic bank customer who wants to purchase a house based on a BBA contract has to first purchase the house from the developer, then sells the house to the bank and subsequently repurchase the house from the bank for a higher deferred price. In all these sale contracts concluded between an Islamic bank and a customer the selling price is higher than the purchase price and the difference is the profit to the bank. The price would be paid by instalments in a certain agreed upon period. The profit to the bank is determined by using the same benchmark which conventional banks use for charging interest and reflects the time factor. The longer the duration of instalment the higher is the profit. An Islamic bank may also use decreasing partnership (*musharakah mutanaqisa*) to jointly purchase a house with a customer, lease it to him and then gradually sells ownership units in the house to the customer.

Islamic banks also use *al-ijarah thumma al-bay'* (Aitab) as an instrument of financing particularly for vehicles and macheneries. Aitab comprises the contracts of lease (*ijarah*) and sale (*bay'*). In Aitab the customer promises to own the asset through lease. The customer chooses the asset and negotiates with the supplier. The bank subsequently purchases the asset and leases it to the customer. The rental is calculated based on the cost of the leased asset and a profit which is calculated against the benchmark for the period of lease. The bank makes a unilaterally binding promise that if the lessee continuously meets his obligations during the lease period the bank will sell the leased asset to him. Thus, at the end of the lease contract, the customer has the option to purchase the asset or to return it to the bank. If he chooses to buy the asset a new sale contract will be concluded. All the rentals previously paid will constitute part of the price. If the customer defaults in rental payments the bank may cancel the lease contract after serving due notice on him.

For providing personal finance an Islamic bank uses commodity *murabahah* or *tawarruq*. An Islamic bank first purchases a certain commodity and sells it to a customer at a deferred higher price. The customer subsequently appoints the bank as an agent to sell the same commodity in the market for a lower cash price. The bank next transfers the price to the customer.

The Critics' Arguments

There is a growing criticism raised against Islamic deposit and financing products. The critics argue that in substance the deposit and financing products of Islamic banks are similar to their conventional counterparts. The difference, they contend, is only in the form and words where some English terms are replaced by Arabic ones. They contend that the gift (*hibah*) given by Islamic banks to their *wadi'ah* account holders and a profit share given to the *mudharabah* investment account holders resemble interest which conventional banks give to their saving account holders. Commodity *murabahah* is also

criticised on the ground that it increases transaction cost but yields similar result to that of a conventional deposit product.

Islamic financing products also came under similar criticism. The critics argue that financial *murabaha* or a BBA contract is hardly an alternative to the conventional mortgage as both are identical. They say that although in form the two transactions are different in substance they produce similar results. For instance, if a person purchases a house for RM100, 000 by borrowing RM100, 000 from a conventional bank, at 10% interest per year, payable in 10 years, he will be paying RM 200,000 at the end of the ten-year instalment period.. The borrower would have to pay RM1667 a month to the bank in 120 equal monthly instalments. Similarly he would end up paying 200,000 in a ten-year instalment period for purchasing the same house from an Islamic bank. He would pay 120 monthly instalments of RM 1667 to the Islamic bank. Thus, whether a person has borrowed RM100, 000 on interest or agreed to purchase a house from an Islamic bank for RM 200,000 in both cases he would end up paying the same amount. They also argue that the fact that the bank owns the house for an hour or a day and resells it to the customer under *murabaha* or BBA does not mean that it is a genuine sale contract. As such they argue that there is no difference between the increase imposed on a debtor for extending the period of loan and the increase in price in credit sale over the price in cash sale. In both cases, they argue, that the increased return to the bank is in lieu of time given to the customer and therefore amounts to interest.

They also argue that *al-ijarah thumma al-bay'* (Aitab) is in substance a copied version of financial lease. The critics argue that in substance Aitab is a financial lease where the bank offers a long-term lease to one lessee and transfer to him the risks and rewards of ownership. They also argue that since the bank does not take ownership risk of the asset the transaction amounts to charging rent on the money and is similar to debt financing.

The critics also distinguish between classical *bay' al-tawarruq* and an organised one. Classical *tawarruq* refers to a contract where a person purchases certain goods/commodities at a deferred higher price in order to sell it in cash to a third party for a lower price. The classical form of the *tawarruq* contract is considered permissible provided it meets the other requirement and conditions of the sale contract. For instance, A asks B to lend him RM 1000. B does not want to lend him money. Instead, B would sell to A an item for RM 1100. The item however can be sold in the market for RM 1000. A buys the article from B for RM 1100 and sells that in the market for RM 1000. Thus A gets the cash but he has to pay B, RM 1100 as the price for the item. In a classical *tawarruq* there is no prior arrangement between the parties. A person purchases an item from another and sells it in the market to a third party. In contrast, in an organised *tawarruq*, they argue, the transaction is not real and exists only in papers. A client approaches a bank for an amount of money to be repaid in an agreed number of instalments. The amount and date of each instalment and the agreed upon mark-up for the deferred duration are determined in advance. The bank will claim to own a commodity and then sell it to the client. The client is not aware of its existence or specifications neither is he interested in the commodity nor is he interested to know

whether or not the bank owns it.¹ The International Council of Fiqh Academy of the Organisation of Islamic Conference (OIC) in its 19th session which was held in Sharjah, United Arab Emirate from 1-5 of *Jamadi Ula* 1430 AH, corresponding to 26-30 April 2009, has decided that organized *tawarruq* is not permissible as it involves simultaneous transactions between the bank and the customer. The Council held that the transaction involves deception in order to get additional quick cash and contain elements of usury (*riba*).

The Proponents Arguments

The proponents of Islamic deposit and financing products contend that these products are based on permissible contracts while conventional deposit and financing products are based on loan that yields interest. An Islamic bank, they argue, take deposits from their customers based on *wadi'ah* contract for safekeeping purposes and return to them their money upon demand. They contend that unlike interest, the *hibah* which an Islamic bank provides to its customers is mainly at the discretion of the bank. Accordingly, the fact that the amount of *hibah* is equivalent to the interest does not make its giving *haram*. They also argue that if an Islamic bank in a *murabahah*/BBA contract purchases certain goods or a house and resells it to the customer the contract is valid as the bank takes the ownership of the goods or the house, as the case may be, and the risk associated with the ownership. If the goods are defective the customer can return them to the bank or if the housing project is abandoned the customer is not bound to pay to the bank its price. The proponents also contend that increasing the price in a deferred sale contract does not amount to usury. Taqi Usmani contends that an increase of price in a deferred sale contract is not usury as in usury money is exchanged for more money while in a deferred sale a commodity is sold for a higher price. He argues that "Any excess amount charged against late payment is *riba* only where the subject matter is money on both sides".² He further argues:

"It is true that' while increasing the price of the commodity, the seller has kept in view the time of its payment, but once the price is fixed, it relates to the commodity, and not to the time. That is why if the purchaser fails to pay at the stipulated time, the price will remain the same and can never be increased by the seller. Had it been against time, it might have been increased, if the seller allows him more time after the maturity".³

The proponents also argue that the fact that Islamic financing products yield the same amount of profit which their conventional counterparts may yield through interest does not constitute a valid objection. Taqi Usmani says if a validly concluded *murabahah* transaction fulfils all the conditions of a valid sale contract "merely using the interest rate as a benchmark for determining the profit of *murabahah* does not render the transaction as invalid, *haram* or prohibited, because the deal itself does not contain interest".⁴

It is also not uncommon to hear arguments where Islamic banking and finance products are compared with permissible (*halal*) chickens, and properly concluded marriages. They argue that Islamic banking products are like chickens that are slaughtered in accordance with the Islamic rites and as such are permissible (*halal*) and valid. In

contrast, conventional products are like chickens that are not slaughtered in accordance with the Islamic rites and consequently are prohibited and void. They argue that that *halal* and *haram* foods may have similar prices but the former is allowed while the latter is prohibited. Muslims still would have to purchase permissible (*halal*) chickens even if it is sold for a higher price. They further say that unlawful sexual relations are prohibited. However, if the parties enter into a marriage contract the relationship becomes permissible. They argue that Islamic banking and finance products are like permissible chickens or properly concluded marriages while conventional products are similar to chickens that are not slaughtered Islamically or unlawful relationships.

These comparisons of Islamic banking products with permissible (*halal*) chickens, or marriages, it is argued, cannot be maintained. When Islamic and conventional banks take deposits from their customers or channel these deposits to them they enter into certain contracts with them. A contract is not a product or a commodity that is offered for sale. It denotes a certain relationship between the parties and creates certain rights and obligations for them. The rights and obligations that result from a *wadi'ah*, *mudharabah*, or a *murabahah*/BBA contracts are different from those that result from an interest-based loan contract. Similarly, unlawful relationship results in sin and does not produce any rights or obligations for the parties. In contrast, marriage is not only offer (*eijab*) and acceptance (*qabul*) but also entails commitment and responsibility. The husband is responsible for giving dower and providing maintenance to the wife and children. The parties can inherit from each other in case of death and the children are legitimate heirs and are entitled to inheritance.

It is therefore argued that any difference between Islamic and conventional deposit and financing products should be established with reference to the underlying contracts that are concluded and the type of contractual relationships that exist between the parties. The contracts that an Islamic bank concludes with its customers should be closely examined, compared, and contrasted with their conventional counterparts. Islamic deposit and finance transactions should be defended in reference to the type of relationship that they create between the parties. It is therefore necessary to discuss the formation of a contract, its pillars, effect, and ensuing rights and obligations.

Contract and its Pillars

'*Aqd* is an Arabic word which literally means to tie, bind, fasten, link together, as to tightly tie the rope, or to bind the two ends of something and thereby forming a strong connection. It also means covenant, fulfilment, agreement, undertakings, obligations and determination. Technically, '*aqd* refers to a legally binding obligation, which has consequences for its subject.⁵ The cause for the existence of a contract is the mutual consent of the parties. In the absence of mutual consent a valid contract does not exist. Consent remains hidden until it is expressed by offer and acceptance of the parties. The Hanafis therefore argue that offer (*eijab*) and acceptance (*qabul*) are the two main pillars of a contract. The presence of the parties and a permissible subject matter and other conditions pertaining to them are considered the requirements for concluding a contract. According to the majority of the *Fiqh* Schools a contract has three pillars which are expression that includes offer and acceptance, the parties, and the subject matter or

the object of a contract. The Maliki and Hanbali jurists have added to these three pillars the purpose of the contract. The Muslim jurists have discussed in details the pillars and their conditions for each individual contract

Intention and Expression

Islam is a religion which emphasises on God's overall knowledge over all things whether they are apparent or hidden. It emphasises the purity of intention and declares that the nature and acceptability of an action depends on intention and motive. The *Qur'an* states:

“Unto God belongs all that is in the heavens and all that is on earth. And whether you bring into the open what is in your minds or conceal it, God will call you to account for it; and then He will forgive whom He wills, and will chastise whom He wills: for God has the power to will anything”⁶

A tradition of the Prophet (pbAbuh) narrated on the authority of 'Umar bin al-Khattab, (ra) states:

“Actions are (judged) by motives (*niyyah*), so each man will have what he intended. Thus, he whose migration (*hijrah*) was to Allah and His Messenger, his migration is to Allah and His Messenger; but he whose migration was for some worldly thing he might gain, or for a wife he might marry, his migration is to that for which he migrated”.⁷

Article 2 of the *Mejelle* which is based on this *hadith* also states: “Matters are determined according to intention”⁸. This is also emphasised by the legal maxim which states: “In contracts effect is given to intention and meaning and not words and forms”.⁹ For instance, in a contract of lease (*ijarah*) the amount of rental is stipulated while in borrowing assets (*i'arah*) such as a car no rental is stipulated. If two persons conclude a contract apparently of borrowing a car but the borrower is charged a certain specific rental, the contract would be regarded as a lease contract. It is because although the wordings of the contract suggest that it is a contract of borrowing (*i'arah*), the intention of the parties and the real meaning of the contract and its result indicate that it is a lease contract. Similarly, in a usurious loan the interest is stipulated while in interest-free loan (*qardh*) it is not. If two persons conclude a contract of apparently an interest-free loan but the borrower is charged a certain additional amount, the true intention of the parties and the real meaning of the contract and its result indicate that it is a usurious loan and not an interest-free loan as the name of the contract suggests. However, if the intention of the contracting parties could not be ascertained, a contract is judged in a court of law based on the form and the words of the agreement.¹⁰ The *Mejelle* states that “in hidden matters, about which it is hard to ascertain the truth, judgement is formed by the apparent evidence about them”.¹¹ In such cases, the intention is judged based on the words that are used in the agreement. In order to ascertain the intention of the parties these words are given their ordinary, and commonly understood meanings.

Intention is a hidden phenomenon. It remains hidden until it is expressed verbally, through acts, gestures, or by writing. It may lead to problems where in certain contract the hidden intention (*iradah batiniyah*) or motive is different from the spoken expression

of offer and acceptance. The Shafi'is and Hanafis, argue that the *Shari'ah* requires that the parties should enter into a certain permissible contract by mutual consent and fulfil all its pillars and conditions. The hidden intention of the parties which is not expressed or referred to in the contract is irrelevant for a judge while deciding on the validity of a contract. According to them the hidden intention or motive cannot be known and is left to Allah (swt). Based on this argument a contract cannot be invalidated on the ground of unlawful intention as it cannot be ascertained. They further contend that the hidden intention or motive changes from a person to a person. Thus, *bay' al 'einah* is contractually valid (*sahih*) if it fulfils the pillars and the necessary conditions of a sale contract. However, it is *makruh tahrimi* to the Hanafis and *haram* to the Shafi'is if the parties intend to use as a vehicle to charge interest.¹²

The Malikis, and the Hanbalis, on the other hand, take into account not only the offer and acceptance but the hidden intention or the motive of the parties while considering the validity of a certain contract. They argue that the hidden intention of the parties could be judged from their subsequent actions. According to them, if the motive of the parties is unlawful, the contract is also void and vice versa. They also use the principle of blocking the means (*sadd al-dhara'i*) to argue for the prohibition of such contracts. According to this doctrine of Islamic jurisprudence (*usul al-fiqh*) a permissible means could be prohibited if it is expected to lead to an unlawful end.¹³ According to this principle the intention of the parties or the actual realisation of the evil result are irrelevant in determining the status of the means. If a certain means could lead to a prohibited (*haram*) end the means will also be prohibited (*haram*).¹⁴

It is possible to argue that in such cases the intention can be determined with reference to the purpose of a certain contract and the ensuing rights and liabilities of the parties. In such cases it is the purpose and the ensuing rights and obligations of the parties which determine the true nature of a contract.

The Legal Effect of a Contract and its Ensuing Rights and Obligations

A valid agreement concluded by the parties brings about the existence of a certain contractual relationship. This relationship is defined by the unique legal consequences (*hukm al-'aqd*) of the contract. Once a contract comes into existence its legal effects or consequences (*hukm al-'aqd*) automatically comes into operation. The legal effect refers to the essential and principal purpose or the original intended effect (*al-ather al-asli*) of a certain contract. For instance, a sale contract automatically transfers the ownership of the sold item to the purchaser and the ownership of the price to the seller. A lease contract transfers the ownership of the usufruct to the lessee. A *mudharabah* contract makes the parties partners in profit and a *musharakah* contract makes the parties partners in capital, profit and loss. The parties are at liberty whether or not to enter into a certain permissible contract. However, once they conclude a contract they are automatically entitled to its legal effect and have to assume the ensuing rights and liabilities.

The legal effect of a contract entitles the parties to certain rights and creates certain obligations for them. These rights and obligations that originate from a contract balance the interest of the contracting parties. For instance in a sale contract the seller must own the sold item as if he does not have the ownership he cannot transfer it to others. Similarly, he is under obligation to deliver the sold item and disclose its defect. He has the right to collect the price of the sold item. In a deferred sale the seller has the right to ask for a guarantor or a pledge. A purchaser, on the other hand, is liable to pay the price and should not violate the terms and conditions of deferred payment. He has the right to take possession of the sold item, to cancel the sale contract by exercising his options if the sold item is defective or is not in accordance with the prescriptions given by the purchaser or does not meet the description of the seller. A lease contract also entitles the parties to certain rights and obligations. The lessor as an owner of the asset is under obligation to maintain the leased asset in proper conditions to enable the lessee to benefit from it. He must also bear the risk of depreciation and un-deliberate damage or loss of the leased asset. He has the right to claim monthly rentals from the lessee. The lessee, on the other hand, is under obligation to pay monthly rentals and take a proper care of the leased asset. During the lease period he holds the leased asset as a trust and is not liable for any damage or destruction of the leased asset unless caused by his negligence. Against these obligations the lessee has the right to benefit from the leased asset for an agreed upon time. However, a financial lease does not produce similar results and does not entitle the parties to similar rights and obligations. The purpose and result of a financial lease is not only to enable the lessee to benefit from the leased asset but also to transfer to him the ownership of the leased asset. The parties also have a different set of rights and obligations. The responsibility for the maintenance is shifted to the lessee. The monthly payments made by the lessee resemble payments of instalments in a loan or a sale contract rather than rentals in a lease contract. The question that could be raised here is whether financial lease is void or whether it is a new contract different from the lease (*ijarah*) contract. The purpose of the contract is to enable the lessee to acquire and own the leased asset and both parties have this intention. The client knows that the rentals he is paying for the lease period include the cost of the leased asset and a profit to the bank. The objective of the bank is to recover its investment or the principal and a fair return on investment¹⁵ and not to act as an owner of the asset. Thus, although the asset belongs to the bank throughout the leasing period it does not take ownership risk and responsibilities but passes them on to the lessee.

The parties to a certain contract may conclude a contract to achieve a purpose which that contract under normal circumstances would not produce. Similarly, a contract may be structured in a way to deprive one or both parties of their rights which that contract normally entitles them. For instance, a sale contract transfers the ownership of the sold item to the purchaser and entitles him to use or deal with it in any permissible way. However, a sale contract where the seller stipulates that the purchaser should not sell or lease the sold item to other persons or should resell or lease it to him deprives the purchaser of his rights which he otherwise is entitled to them. Similarly, a lease contract entitles the lessor to rentals and the lessee to benefit from the leased asset. It also results in the obligation of the lessor to undertake ownership risk and maintenance of

the leased asset. However a lease (*ijarah*) contract which transfers ownership risk and maintenance obligations to the lessee burdens him with liabilities which he otherwise should not take. In both these examples the contracts of sale and lease do not entitle the contracting parties to their rights and obligations assigned to them by the *Shari'ah*. In such cases in form these two contracts are sale and lease but not in substance.

Vitiating Conditions

In order for a contract to produce its original intended effect and all its ensuing rights and liabilities it should be free from vitiating conditions. These are conditions that can potentially disturb the balance of interest between the parties and may favour one of them at the cost of the other. The *Shari'ah* therefore has prohibited all those conditions that may change the effect of a certain contract and entitle the parties to a different set of rights and obligations. For instance, the effect of a *mudharabah* contract is that the *sahib al-mal* should bear the losses and that the profit should be shared between the *sahib al-mal* and the *mudharib*. The capital provider cannot stipulate that the *mudharib* should guarantee the capital or a certain amount of profit. Conditions stipulating the guarantee of capital and profit will change the effect of a *mudharabah* contract and will entitle the parties to a different set of rights and obligations. Similarly, a seller cannot stipulate that the purchaser should lease the sold property to him, or should resell it to him, or should never sell it. All these conditions negate the ownership right of the purchaser which was transferred to him by the sale contract. The purchaser as an owner can decide to whom he should lease or sell his property. These should not be dictated by the seller who no longer has the ownership. Similarly, it is not allowed for a lender to put any condition in a loan contract that would benefit him as this amounts to usury. A lender, for instance, cannot stipulate that the borrower should purchase a certain property from him. Most of the time prohibited conditions lead to usury or may favour one of the parties at the expense of the other.¹⁶

The parties may conclude a contract to achieve a purpose or a result which is prohibited by the *Shari'ah*. For instance, the purpose behind a gift (*hibah*) contract is to strengthen relationship between the parties. However, a person may use the contract of *hibah* to transfer his wealth to his wife in order to evade *zakat*. In this case the contract is used for a purpose which is prohibited by the *Shari'ah*. Similarly, the purpose behind a sale contract is to enable the parties to transfer and acquire ownership. However If a person sells an asset for a higher price in deferred terms and buys back the same asset for cash then the sale contract is used not for the transfer of ownership but for the provision of cash and charging the receiver an extra amount. This deviation from the main purpose of a contract in order to achieve another mostly unlawful purpose is most frequently made possible through the application of legal tricks (*hiyal*). *Hiyal* refers to a legal device or fiction employed to avoid a direct violation of Islamic law. These legal fictions were mainly used to enable an individual to indirectly achieve a certain result which he could not directly achieve it due to *Shari'ah* prohibition. Hamid Sultan JC in *Malayan Banking Berhad v Ya'kup bin Oji & Anor* while referring to legal fictions observed:

“However, it is not uncommon to find literature by Islamic jurists who have approved or authored Islamic trading instruments in form and not in substance to adulterate the meaningful injunction of verses 2: 275 for commercial gains. This activity has been perpetuated for centuries under the concept of *helah* (legal fiction or legal trick). This doctrine was developed by jurists to achieve a purpose, which in form is seen to be within the spirit of *Syariah* law, but the end result was not seen to be important by the jurists. In principle, these jurists take the view that intention is not an essential element in the Islamic banking system, as long as the form subscribes to the compliance of Islamic norms of *riba*. If not for the acceptance of *helah* in modern Islamic literature, the operation of many products or instruments offered by *Syariah* banks will appear to be an infringement of the Quranic injunctions. Criticism of modern *Syariah* banking is based on this. Notwithstanding objections and controversies by jurists in respect of the doctrine of *helah*, the doctrine has contributed to the modern literature on *Syariah* banking. The objections are not without reasons. The extensive number of legal stratagems used by jurists to avoid or limit the strict prohibition of Quranic injunctions is seen to adulterate the pure and divinely ordained system. For example, despite the prohibition of *riba*, a loan with interest in modern times is neatly camouflaged and justified by circuitous logic by the method of a double sale. This is simply done by A, a lender who would purchase an object from B, for an agreed price X payable immediately in cash. B would then contract to repurchase the same subject matter from A for a price X+I (I representing the agreed interest though defined as profit) payable by future specified date. The authors of those instruments will often argue jurisprudential justification for its creation as they are often financially rewarded for their efforts. Such arguments will appear to be in breach of *Syariah* principles. As a result, presently we see many innovative Islamic financial instruments parallel to conventional banking instruments, which may not be within the spirit and intent of the Quranic injunctions.”¹⁷

A Purposive (*Maqasidiq*) Approach

It is the purpose of the *Shari'ah* that a person should use his wealth (*mal*) in a way that is beneficial to him and the society. This is possible when the wealth is invested as investment benefits both the owner and the society. Islamic law has therefore the most diverse range of contracts. Under the category of sale, for instance, there are bargain (*musawamah*) and trust (*amanah*) sales. Trust sales are also divided into *murabahah*, *tawliyah*, and *wadhi'ah* sales. There are also *salam*, *istisna'*, and *sarf* varieties of sales. There are also different varieties of *ijarah* contract that include both leases and employments. Different varieties of partnership contracts such as *musharakah*, *mudharabah*, and share-cropping contracts of *musaqat*, and *muzara'ah* have long been in practice in the Muslim world. Besides these contracts other transactions include agency (*wakalah*), loan (*qardh*) borrowing (*i'arah*), guarantee (*kafalah*), transfer of debt (*hawalah*), pledge or mortgage (*rahn*), safekeeping (*wadi'ah*), bill of exchange (*suftajah*), set off (*muqasah*), settlement (*sulh*), absolution (*ibra*), contract of reward (*ju'alah*), etc. In order to further encourage investments the general principle with regard to transactions is permissibility. It means that all types of commercial and financial

transactions are permissible except those that are specifically prohibited or have prohibited elements.

In contrast Islam has emphatically and in the strongest words prohibited usury or interest (*riba*). Usury guarantees a certain fixed return to the lender while the benefit to the borrower and the society at large is not certain. Islam strongly prohibits to the lender not only charging interest but any other benefit that he may derive from the loan whether the loan is for investment or consumption purposes. Similarly, a person is strongly discouraged from borrowing money. The Prophet (pbAuh) would not offer funeral pray on those Muslims who died indebted except when the settlement of the debt was guaranteed. Even martyrdom repeated three times would not help a person who dies indebted and the debts are not settled. The prohibition of usury and any other benefit to the lender and discouraging a person from borrowing money indicate that it is one of the objectives of the *Shari'ah* that the wealth a person has should be invested and not given as a loan. As an owner and investor of wealth he must share the risk and rewards of the investment with others. However, today Islamic banks use devices such as commodity *murabahah* or *tawarruq* and agency (*wakalah*) contracts to give the fund provider a fixed return. They also use commodity *murabahah* and repurchase sale (*bay al-'ainah*) contracts to demand fixed returns from the users of the funds irrespective of the outcome of their uses. Hamid Sultan JC in *Malayan Banking Berhad v Ya'kup bin Oji & Anor* has said:

“Islamic law of commercial transaction fundamentally is rooted on the premise of total eradication of *riba* and *gharar* (uncertainty). It is seen as a coherent system designed to cater for human welfare to achieve maximum benefit. The law of commercial transaction balances the moral and material needs of society to achieve socio-economic justice. The very objective of the Syariah is to promote the welfare of the people, which lies in safeguarding their faith, life, intellect, posterity and property.”¹⁸

Conclusion

This paper concludes Islamic deposit and financing transactions should not only be procedurally different from their conventional counterparts but also in substance. This paper also concludes that in order to determine whether or not a certain transaction in substance complies with the *Shari'ah* it is not enough to look at the intention of the contracting parties. The classical discussion on the intention of the contracting parties was made in the context of natural persons. It is necessary to re-examine its application to financial institutions that are legal entities. This paper therefore argues that Islamic deposit and financing transactions must lead to results which are assigned to them by the *Shari'ah*. They must also give the parties all those rights and obligations which these contracts entitle them under Islamic law. The paper concludes that Islamic deposit and financing transactions should be defended based on their own merits and substance and not based on their forms and procedural differences with their conventional counterparts.

Endnotes

- ¹ For a discussion see Mohammed Obaidullah, *Islamic Financial Services* pp. 109-112
- ² Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, p.115.
- ³ *Ibid*, p. 116.
- ⁴ *Ibid*, p. 119.
- ⁵ Wahbah Zuhaili, *al-Fiqh al-Islami Wa Adillatuhu*, vol. 4, pp. 80-83. See also S. E. Rayner, *The Theory of Contracts in Islamic Law*, pp. 87-9.
- ⁶ The Quraan, 2: 284, translation taken from Muhammad Asad, *The Message of the Quraan*.
- ⁷ Imam Yahya ibn Sharaf al- Nawawi, *Forty Hadith, Arabic text, translation & explanatory notes*, hadith no. 1.
- ⁸ *The Mejelle*, translated by C.R. Tyser, D.G. Demetriades, and Ismail Haqqi Effendi, Article 2.
- ⁹ *The Mejelle*, Article 3.
- ¹⁰ See Subhi Mahmasani, *The Philosophy of Jurisprudence in Islam*, pp. 161.
- ¹¹ *The Mejelle*, Article 68.
- ¹² Wahbah Zuhaili, *al-Fiqh al-Islami Wa Adillatuhu*, pp. 186.
- ¹³ Mohammad Hashim Kamali, *Principles of Islamic Jurisprudence*, pp. 310-11.
- ¹⁴ *Ibid*, p. 311.
- ¹⁵ Mohammed Obaidullah, *Islamic Financial Services* p. 83.
- ¹⁶ Wahbah Zuhaili, *al-Fiqh al-Islami Wa Adillatuhu*, 204-5; Nayla Comair-Obeid, *The Law of Business Contracts in the Arab Middle East*, p. 38.
- ¹⁷ *Malayan Banking Berhad v Ya'kup bin Oji & Anor* [2007] 6 MLJ, p. 408.
- ¹⁸ *Malayan Banking Berhad v Ya'kup bin Oji & Anor* [2007] 6 MLJ, p. 400.

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