

ISLAMIC FINANCE DISCOURSES

Muhammad Abdurrahman Sadique

'Islamic Finance Discourses' examines three contractual processes known as murabahah, tawarruq and 'inah, which are varieties of sale discussed in Islamic legal literature that have gained prominence with the upsurge in Islamic banking in the recent decades. While murabahah comprises a single contract of sale, each of the remaining two refers to a process involving two fully independent sale contracts. In the original format discussed in Islamic law, murabahah is duly recognised as a valid classification of sale, whereas the validity and recognition of the other two have not been universal, especially 'inah, which has come under juristic disapproval in many of its forms. These contracts, which are not among the important varieties of contracts in Islamic law, have drawn undue attention and prominence with their application as alternatives to interest based loans in Islamic banking. The current work explores their essential nature and details as discussed in Islamic legal manuals, followed by a scrutiny of their adaptations in contemporary Islamic banking. It attempts to provide an analytical perspective of the areas discussed, and should prove to be of interest to academics and students of Islamic law and finance.

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Preface

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Forms of Tawarruq: validity and viability

Forms of Tawarruq: validity and viability

INTRODUCTION

The simple mechanism of tawarruq, where a person in need of cash purchases an asset on credit and thereafter sells it on cash to a third party, is becoming increasingly adapted for financing purposes by modern Islamic financial institutions. Short term financing where various adaptations of murābahah were employed as the standard mode by many Islamic banks is also done today on tawarruq, which has provided Islamic banks with a much needed addition to the array of products aiming to provide financing in ways approved by the shari'ah. Despite of its increasing popularity, there exists some controversy on its admissibility as a genuine Islamic product that could be resorted to constantly by Islamic banks for financing purposes. The operational method developed by Islamic banks for implementing tawarruq financing in the arena of modern banking and commerce reflects several features that have been incorporated into the tawarruq contract as has been discussed by traditional jurists. While the original tawarruq is contemplated to have consisted of two contracts of sale, modern adaptations usually comprise three, or possibly more. The primary reason for this development is that the banking institution, acting as a mere intermediary, is not in possession of commodities that could be readily brought into the tawarruq financing process, and needs to liaise with a trader, usually an external party, for the purpose. Similarly, disposal of such commodities by the seeker of the facility sometimes needs to be further simplified by the mediation of an agent. Thus, the product in its final shape is to a large extent more complex, and also more streamlined as in the case of many banks, than the simple form of tawarruq debated by jurists. As a corollary to the smoothness of the whole operation, there is also the undeniable danger of the transactions merely becoming a formality observed on paper without proper regard

to the material aspects that should be necessarily involved. These additional aspects along with some other variations that have been introduced have further fuelled the controversy on its admissibility as a mode of financing.

Despite of its recognition in its basic form by several contemporary bodies of Islamic scholars, different types of *tawarruq* offered by various Islamic banks remain a heavily discussed issue among scholars in the field. While some recognise it as a welcome addition to Islamic financing techniques, others do so only with caution and with stringent conditions imposed. Yet others refuse to uphold its admissibility. The basic objection to such modes is that the explicit aim being the obtaining of cash against undertaking a future debt for a higher amount, it falls under a *ribā* based relationship, the transaction only acting as an unessential formality. The treatment of *tawarruq* in this article is submitted in two parts, developed around the following major areas. The first part explains the nature of *tawarruq* as perceived by Islamic jurists and discusses the admissibility of *tawarruq* in its simple form in *sharī'ah*. The second part analyses the nature of financing products developed by Islamic banks on the basis of *tawarruq* with a critical appraisal of their validity and advisability.

PART 1

NATURE OF TAWARRUQ IN CLASSICAL ISLAMIC LITERATURE

The Arabic term *tawarruq*, originating from the root *wariq*¹ that denotes silver, minted or otherwise, has been held to mean 'seeking or acquiring silver', as in the case of *ta'allum*, or seeking 'ilm, i.e. learning.² Thereafter, the meaning has expanded to include seeking for, and striving to obtain money in any form, be it silver, gold or any other currency. Thus the literal meaning of the term implies any means of obtaining finance, or liquidity. The use of this term to denote a specific

¹ A Qur'anic word; Surah al-Kahf, verse 19.

² Abdullah ibn Sulaymān al-Manī', "al-Ta'sīl al-Fiqhī li'l-Tawarruq" in *Majallah al-Buhūth al-Islāmiyyah*, Riyādh, 1425H. p. 353.

method of obtaining finance involving several contracts appears to have been done by the Hanbali scholars. Al-Bahūti, a noted Hanbali scholar, has made reference to the structure in question involving two sales as *tawarruq* in his *Kashshāf al-Qinā'*.³ The term 'zarnaqah' too has been used in this context by some scholars, which bears the literal meaning of increase or growth. The *modus operandi* referred to as *tawarruq* by Hanbali scholars has also been known as *zarnaqah*. This term is noted to have been used also to refer to the sale of 'īnah.⁴

Tawarruq in Islamic legal literature denotes a particular structure that could be employed by a *mutawarrīq* / *mustawriq*, i.e. a person in need of liquidity, without resorting to borrowing on interest. This comprises the credit purchase of an asset the value of which is roughly equal to the amount required by him, usually for a higher price that could compensate for the delay in settlement, and the subsequent sale of the asset on cash, so that the necessary amount of money is realised. It is necessary that the second sale is not concluded with the seller from whom the asset was initially purchased. The Encyclopaedia of Islamic Law published by the Ministry of Awqaf of Kuwait defines *tawarruq* as purchasing a commodity on credit and selling it to a person other than the initial seller for a lower price on cash. This structure has been described in a similar fashion by jurists. Al-Bahūti, describing the position of the Hanabali school, says: If one is in need of cash, and purchases an asset, whose actual value is hundred, for one hundred and fifty, it is not objectionable, as has been borne out by legal texts. This transaction is named *tawarruq*. This structure has been discussed under the topic of 'īnah by jurists of the other schools. The Islamic Fiqh Academy of Jeddah has described *tawarruq* as the purchase of a commodity that is in the ownership and possession of the seller against a deferred price, and its subsequent sale by the purchaser to a party other than the seller on cash, for the purpose of obtaining cash, i.e. *wariq*.⁵

³ Al-Bahūti, *Kashshāf al-Qinā'*, vol. 3, p. 186.

⁴ *Al-Nihāyah fī Gharīb al-Hadīth*, vol. 2, p. 301.

⁵ Resolution No. 5, 15th Session held in Makkah on 11th Rajab 1419H (31.10.1998)

Some have identified three forms of tawarruq described by jurists.⁶ In the first, the person in need of cash purchases a commodity on credit and sells it to another on cash, without any party being aware of his need or intention. In the second, the one in need requests for a loan from a trader, who excuses himself from lending to him, but conveys his willingness to sell a commodity to him on credit for its cash price. The mutawarriq then sells it at any possible price, be it more than the purchase price or less. These two forms appear universally accepted without any difference of opinion. The third form is similar to the second, except that the trader sells the commodity to the mutawarriq for a price higher than its market value, against the delay in payment. This is the form where jurists have differed, as discussed hereunder.

'Īnah and tawarruq

Tawarruq has been also referred to as three party 'īnah, in order to differentiate it from 'īnah proper, which takes place between two parties only. In the latter, one who requires liquidity purchases an asset from a seller on credit, thereafter sells it on cash at a price lower than the purchase price to the seller himself. According to some, this transaction has been termed 'īnah because the particular asset purchased ('ayn in Arabic) had found its way back to the original seller. This fact strongly indicates that the asset had been utilised merely as a hīlah or legal stratagem for earning ribā, on the basis of which many had ruled the transaction prohibited. Tawarruq, on the other hand, involves three parties. Here, a person who needs liquidity purchases an asset from another on credit, and thereafter sells it, usually for a lower price, to a person other than the original seller, i.e. to a third party, so that the structure does not give a ready indication of a hīlah adopted solely for circumventing ribā. Since the asset in this case does not return to the original vendor and is sold to a third party, many have regarded the structure valid and acceptable.

⁶ Al-Siddīq al-Darīr, "al-Tawarruq al-Masrafi – al-Ra'y al-Fiqhī", in *Hawliyyah al-Barakah*, Ramadan 1425H

Acceptance of tawarruq in its simple form among Islamic jurists

Even though there has been some objection to its practice from certain scholars, the overwhelming majority appear to have considered tawarruq legally permissible.⁷ Many jurists from the schools of Hanafi, Shāfi'ī and Hanbali have ruled this structure valid. As mentioned above, while Hanbali jurists have used the term tawarruq for this practice, jurists of other schools have described similar structures and have preferred their permissibility. The Hanafi jurist al-Kāsānī has upheld the validity of a similar configuration on the basis that the change of ownership that takes place in this instance, is tantamount to change of the asset according to him, thus ruling out the possibility of ribā.⁸ In addition to former jurists, many contemporary shari'ah scholars have regarded this contract acceptable, among them the late Abdul Azīz ibn Bāz,⁹ and Muhammad ibn Sālih al-Uthaymin, who has imposed some conditions for its permissibility. A number of shari'ah supervisory boards of Islamic banks too have upheld the validity of tawarruq, including the shari'ah boards of al-Rājihi bank and Kuwait finance house. Islamic Fiqh Academy, an arm of the Organisation of Islamic Conference, in its 15th session held in Makkah, had issued a resolution supporting the permissibility of tawarruq, on condition that the purchaser of the asset does not sell it to the original seller at a price lower than the initial purchase price, directly or indirectly, as in the latter case it would involve ribā.

Among those who have censured tawarruq and found it unacceptable, although some individual scholars figure prominently, the absence of any school as a whole is noteworthy. Although Māliki jurists have not specifically condemned it, they have considered offensive the sale of an

⁷ Ministry of Awqāf, Kuwait, *Al-Mawsū'ah al-Fiqhiyyah al-Kuwaytiyyah*, vol. 14, p. 63.

⁸ Al-Nawawī, *Rawdah al-Tālibīn*, vol. 3, p. 416, al-Kāsānī, *al-Badā'i'*, vol. 7, p. 96, al-Mardāwī, *al-Insāf*, vol. 4, p. 337.

⁹ *Majmū' Maqālāt wa Fatwā*, vol. 19, pp. 19 – 99. This is important due to the negative ruling on the issue by Ibn Taymiyyah and Ibn al-Qayyim.