



ISLAMIC CONTRACTS IN MUAMALAT: MUA`WADAH (EXCHANGE) CONTRACTS

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APPROACH TO UNDERSTAND MUAMALAT CONTRACTS

Islamic contracts may be classified into sales-based contracts (trading contracts), contracts of participation and other supporting contracts like Hibah (gift), contracts of safe custody etc.

Trading contracts are considered to be the fundamental contracts in Islamic law. Proof on the importance of trading contracts can be found in the Qur'an itself. When comparing what is legal and what is illegal, a broad comparison is made between trade (bai') and riba.

Surah al-Baqarah verse 275 clearly indicates that sales and trade are permitted as a general rule of business.

وَحَرَّمَ الْبَيْعَ اللَّهُ وَأَحَلَّ الرَّبَّاءَ مِثْلُ يَتَخَبَّطُهُ الشَّيْطَانُ مِنَ الْمَسِّ ذَلِكَ بِأَنَّهُمْ قَالُوا إِنَّمَا الْبَيْعُ الَّذِي يَأْكُلُونَ الرَّبَّاءَ لَا يَقُومُونَ إِلَّا كَمَا يَقُومُ الَّذِي الرَّبَّاءَ

*“Those who eat Riba will not stand (on the Day of Resurrection) except like the standing of a person beaten by Shaytan leading him to insanity, That is because they say: **“Trading is only like Riba,”** whereas Allah has permitted trading and forbidden Riba”*

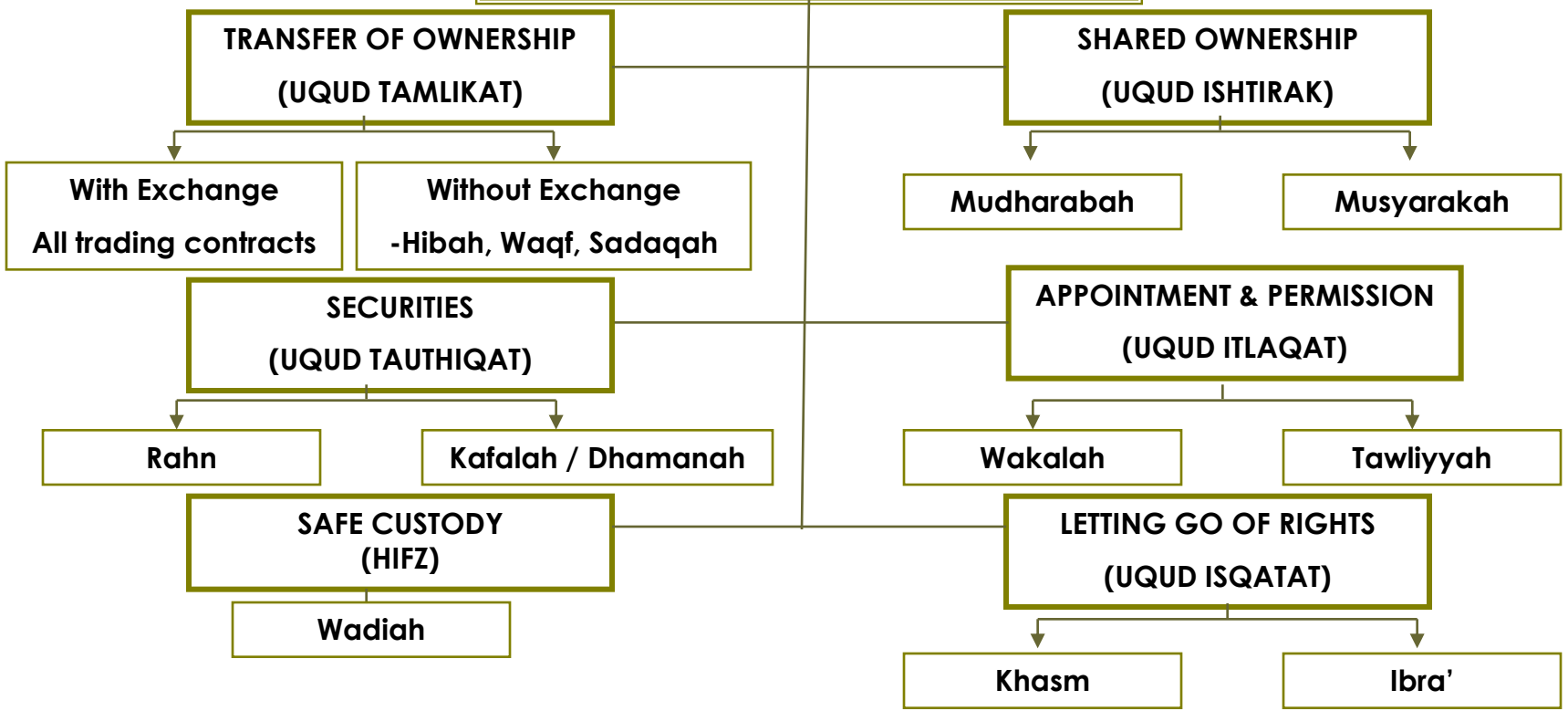
مِنْكُمْ تَرَاوِعَ عَنْ تِجَارَةٍ تَكُونُ آمِنًا لَا تَأْكُلُوا أَمْوَالَكُمْ بَيْنَكُمْ بِالْبَاطِلِ إِلَّا أَنْ يَأْتِيَهَا الَّذِينَ

“O you who believe! Eat not up your property among yourselves unjustly except it be a trade amongst you, by mutual consent” (Nisa :29)

- Al-Bukhari recorded that Samurah bin Jundub said in the long Hadith about the dream that the Prophet had,
(We reached a river -the narrator said, "I thought he said that the river was as red as blood"- and found that a man was swimming in the river, and on its bank there was another man standing with a large collection of stones next to him. The man in the river would swim, then come to the man who had collected the stones and open his mouth, and the other man would throw a stone in his mouth.)
- Dealing with riba is forbidden not only in the Islamic (sharia'h) laws, but also in the previous divine legislation. Allah (S.W.T.) says about the Jews in surat An-Nisa', (Verses 160 & 161), what can be translated as, "For the wrong -doing of the Jews, We made unlawful to them certain good foods which had been lawful to them, and for their hindering many from Allah's Way. And their taking of riba (usury/interest) though they were forbidden from taking it and their devouring of men's substance wrongfully."
- "Do not charge your brother interest, whether on money or food or anything else that may earn interest." (**Deuteronomy 23:19**)
- "Do not take interest of any kind from him, but fear your God, so that your countryman may continue to live among you." (**Leviticus 25:36**)
- "If you lend money to one of my people among you who is needy, do not be like a moneylender; charge him no interest" (**Exodus 22:25**)

ISLAMIC CONTRACTS APPLIED IN ISLAMIC FINANCE

CONTRACTS ACCORDING TO THEIR PURPOSES



TRADING CONTRACTS

The Shariah requires the following contracts to be made with **immediate payment** :

- i. Sarf (foreign currency exchanges)
- ii. Exchanges between ribawi materials of different kinds and of the same basis (gold with money or wheat with barley)
- iii. Bai Dayn

TRADING CONTRACTS (cont)

Trading contract with **deferred payment (debt financing)** :

- i. Bai Murabahah (cost plus)
- ii. Bai Tawliyah (novation)
- iii. Bai Wadhiah
- iv. Bai Salam
- v. Bai Istisna'a (sale by order)
- vi. Bai Bithaman Ajil (deferred payment sale)
- vii. Bai Istijrar (supply or whole sale financing)
- viii. Bai Inah
- ix. Ijarah (leasing)
- x. Kiraa' Waqtinaa' (leasing then procurement)

The concept of aqad.

The literal meaning of “aqad” is “join” or “tie”.

The English word for “aqad” is “contract”.

The Shariah term for “aqad” or “contract” as given by the author of al-'Inayah is :***“legal relationship created by the conjunction of two declarations, from which flow legal consequences with regard to the subject matter”***.

A contract must consist of :

AQIDANI: the two parties to the contract.

SIGHAH: the ijab and qabul (offer and acceptance)

MA'AQUD ALAIH : the subject matter and price.

ESSENTIAL ELEMENTS OF THE CONTRACTS

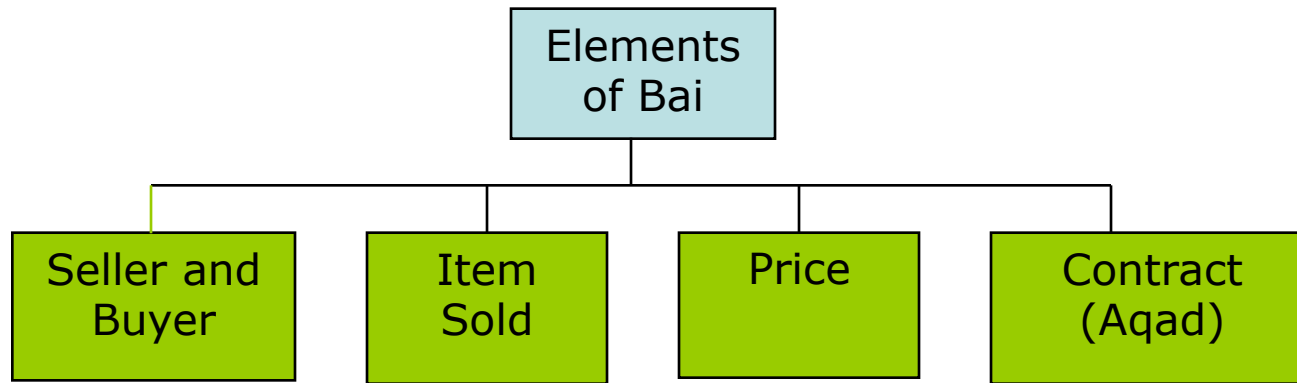
1) TRADING CONTRACTS

To make a contract valid it must have essential elements and each essential element must meet the necessary conditions.

There are five essential elements of sale and six of Ijarah:

Sale	Ijarah
(i) Seller	(i) Lessor
(ii) Buyer	(ii) Lessee
(iii) Item sold	(iii) Benefit (use or usufruct)
(iv) Price	(iv) Rental
(v) Contract	(v) Contract

ESSENTIAL ELEMENTS OF THE SALE CONTRACT (ARKAN AL-BAI)



1) Contract of Sale

(1) and (2) Seller and Buyer.

There are three necessary conditions of seller and buyer.

- i. capable of taking responsibility. They must :
 - be of sound mind, i.e. not mad, not mentally retarded, nor children (aqil)
 - have reached the age of puberty (baligh), and
 - have reached majority (rasheed/ 18 years old) (able to manage their own affairs)

ESSENTIAL ELEMENTS OF THE CONTRACTS (cont)

- ii. not prohibited from dealing with their property, i. e:
 - not declared bankrupts, or
 - not declared prodigals
- iii. no coercion is exerted on either of them
- iv. not a blind person (blind person must appoint an agent)

Note:

The essential elements and necessary conditions elaborated above are for seller and buyer who are individuals. For institutions, the applicable necessary conditions are the same following the legal practices of one's country. In addition, the individuals representing the institutions must possess all the listed necessary conditions.

ESSENTIAL ELEMENTS OF THE CONTRACTS (cont)

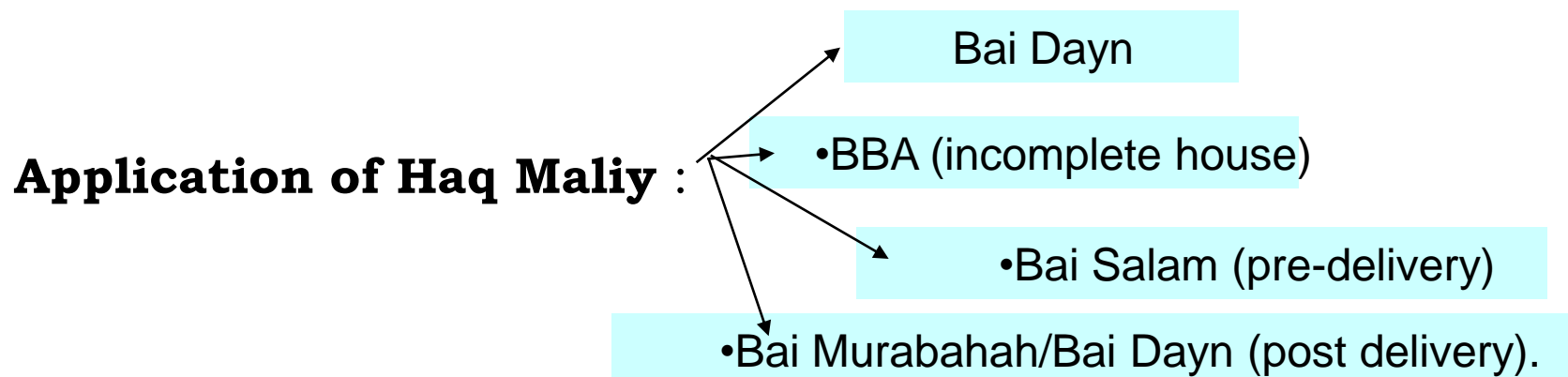
3) Item sold.

There are six conditions :

i. It must exist

The Haq Maliy Principle

- Haq maliy are rights on assets with financial values, examples of such rights are haq dayn (debt rights) and haq tamalluk (ownership rights).
- Haq ghair maliy are rights not related to assets with financial values, (haq hadanah-child custody rights) and haq wali-(right to be a wali)



ESSENTIAL ELEMENTS OF THE CONTRACTS (cont)

ii. It must be **halal/pure according to Shariah.**

It must not be :

- 1. a pig or its product/a dog or its product
mixed animal (pig + dog= haram
(Pig/dog + Goat = Haram**
- 2. a carcass**
- 3. an intoxicating drink**
- 4. blood**
- 5. vomit**
- 6. excreta i.e. faeces or urine**

All animal skin (except pig and dog`s skins)- after purification/samak = pure/halal

ESSENTIAL ELEMENTS OF THE CONTRACTS (cont)

- iii. It must have use according to the Shariah (present or in the future).**
 - It must not be too little as to be of no use, such as a few grains of rice or half a date fruit.
 - It must not distract from remembering Allah, like musical instruments.
 - It must not be used for haram purposes like worshipping other than Allah, practicing riba or gambling.
- iv. It must be owned by the seller.**
- v. It must be capable of being delivered**
- vi. it must be free from encumbrances (refinancing/selling of lease asset)**
- vi. It must be known and specific by address, description or specification.**

POSSESSION OF THE ASSET.

*“Just as the possession of the commodities may be physical, by **taking the commodity in one`s hand or measuring or weighing the eatables**, or by **transferring or delivering** the commodity to the premises of the buyer, the possession also be in implied or constructive possession, which takes places by **leaving the commodity at one`s disposal and enabling him to deal with it as he wishes**. This will be deemed a valid possession even though the physical possession has not taken place”.*

Fiqh Academy Islami of OIC.

4) Price

There are two necessary conditions of price as follows:

- i. known currency/payment (monetary system/barter trade)
- ii. absolute amount

5) Contract

Contract has three conditions which are :

- i. The offer and acceptance must be **absolute** and **in definite** and **decisive** language.
 - It must ***not be conditional***
 - It must ***not be***:
 - to a certain time like a certain day or date, or
 - limited to a certain period of time like one year or ten years.
 - It must be in the present or past tense; it must not be in the future tense, imperative or with the words : ***agree to/ shall/ may/ will***

ESSENTIAL ELEMENTS OF THE CONTRACTS (cont)

1. VERBAL (Lisan)	<ul style="list-style-type: none">• Original form of 'aqad
2. WRITTEN (Kitabah)	<ul style="list-style-type: none">• Recommended (sunnah) when a debt is involved.
3. BY DEED AND WELL KNOWN SIGNS	<ul style="list-style-type: none">• Permitted where the items sold does not cost a lot of money.• Known as "bai' al-ta'ati."

"O believers! **When you contract a debt for a fixed period, write it down.** Let a scribe write in down in justice between you. Let not the scribe refuse to write, as Allah has taught him..."

(Surah al-Baqarah: Verse 282)

ESSENTIAL ELEMENTS OF THE CONTRACTS (cont)

- ii. The acceptance must agree with the offer.
- iii. The offer and acceptance must be made at the one and the same meeting.

CONDITIONS IN A CONTRACT

“Muslims are bounded by the condition they made, except a condition that renders permissible an impermissible act or prohibits a permissible act.”

Condition –

1. against the muqtada/requirement of the contract- contract and condition = invalid
3. Not against muqtada = both contract and condition are valid
4. Against Shariah text/proof = condition invalid, contract valid
5. Contain gharar elements = condition invalid, contract valid.

Types of Sales (continue)

3. Valid but disliked sale (Bai Makrooh):

A sale will be Makrooh when the transaction is complete and one gets possession of the goods but is disliked eg.

sale after Juma Azaan

sale after hoarding

where a third party intervenes to buy something which was under negotiation of sale between other parties.

Application of Sale contracts

Bai Inah

Bai Inah is a sale in order to get cash, not property or a sale in which a commodity is sold for a deferred payment (*thaman mu' ajjal*) and then resold to the seller on cash basis (which is cheaper than deferred payment price).

The owner of the commodity will get the commodity back plus the payment which is deferred whilst the customer will get 'cash' and settle the payment obligation on installment basis. It should not involve ribawi asset.

Bai Bitthaman Ajil (BBA)

It refers to the manner of payment – deferred payment sale.

Bai Bithaman Ajil is also known as Bai Muajjal or Bai Taqsit.

Technically, it is a sale of commodity on deferred payment basis whether on the basis of lump sum or installments. It should not involve ribawi asset.

Application of Sale contracts

Bai Murabahah (cost+profit)

Bai Murabahah is a sale of commodity for the price at which the seller has purchased it, with the addition of stated profit known to both the buyer and seller.

The basic elements of Bai Murabahah are that the seller discloses the actual cost price of the commodity together with the profit added thereon. It is to be noted that the profit is not necessarily to be in figure form. It can also be based on percentage.

Illustration:

Commodity: crude palm oil

Cost Price: RM100,000

By way of Bai Murabahah: the sale price is RM130,000 [RM100,000) + RM30,000 (profit)]

Musawamah

Sale of goods at a price on which the buyer and seller agree after haggling without mentioning the cost of the seller.

Application of Sale contracts (cont)

Bai Salam

Bai Salam refers to an agreement whereby payment is made immediately while the goods are delivered at an agreed later date.

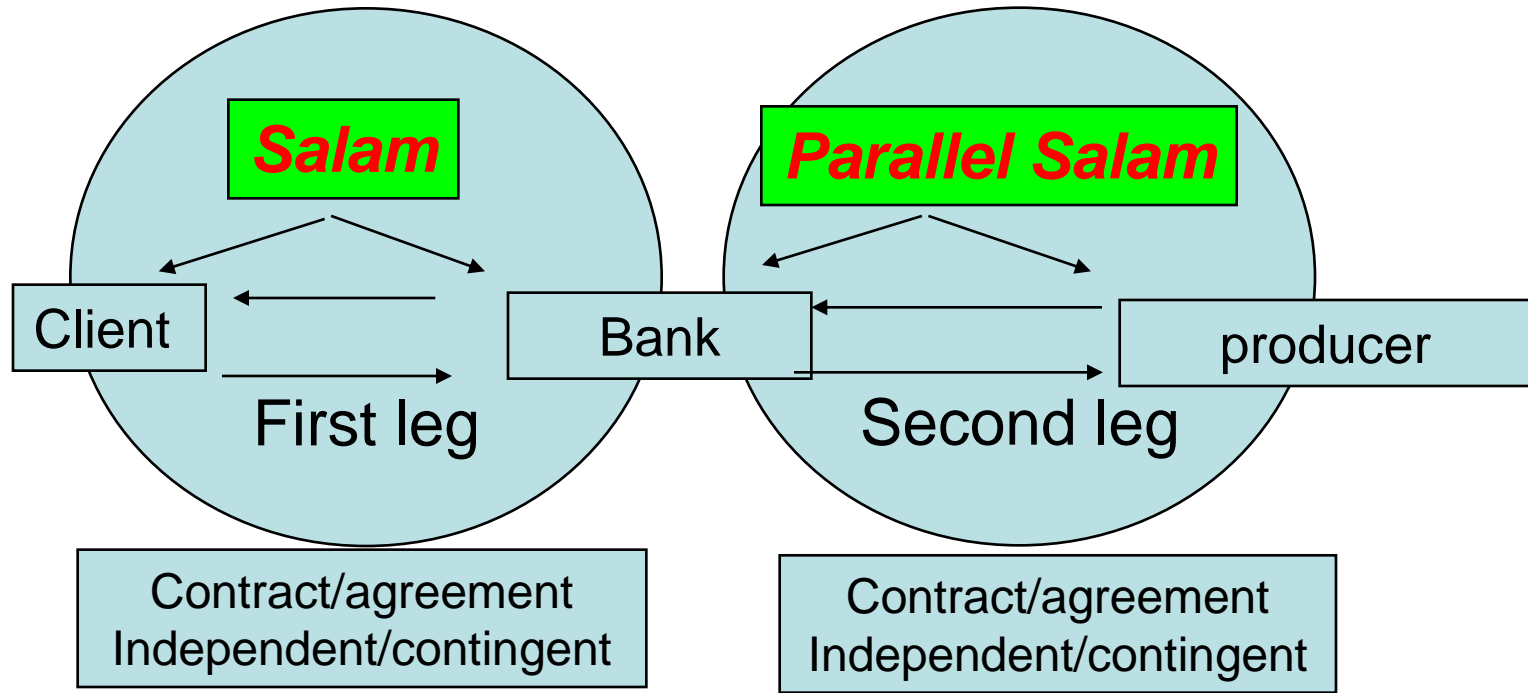
Bai Salam is permissible in Shariah. It was narrated by Ibn Abbas that the Prophet Muhammad (PBUH) said, “*Whoever enters into a contract of Salam must effect the Salam according to specified measure, specified weight and specified date of delivery*”.

Application of Sale contracts (cont)

Conditions of Salam:

1. It is necessary for the validity of Salam that the buyer pays the price in full to the seller at the time of effecting the sale.	✓
2. Only those goods can be sold through a Salam contract in which the quantity and quality can be exactly specified eg. precious stones cannot be sold on the basis of Salam because each stone differ in quality, size, weight and their exact specification is not possible.	✓
3. Salam cannot be effected on a particular commodity or on a product of a particular field or farm eg. Supply of wheat of a particular field or the fruit of a particular tree, share of particular company.	✓
4. The exact date and place of delivery must be specified in the contract.	✓
5. Salam cannot be effected in respect of things, which must be delivered at spot.	✓
6. The commodity for Salam contract should remain in the market right from the day of contract up to the date of delivery or at least till the date of delivery.	✓

Application of Sale contracts (cont)

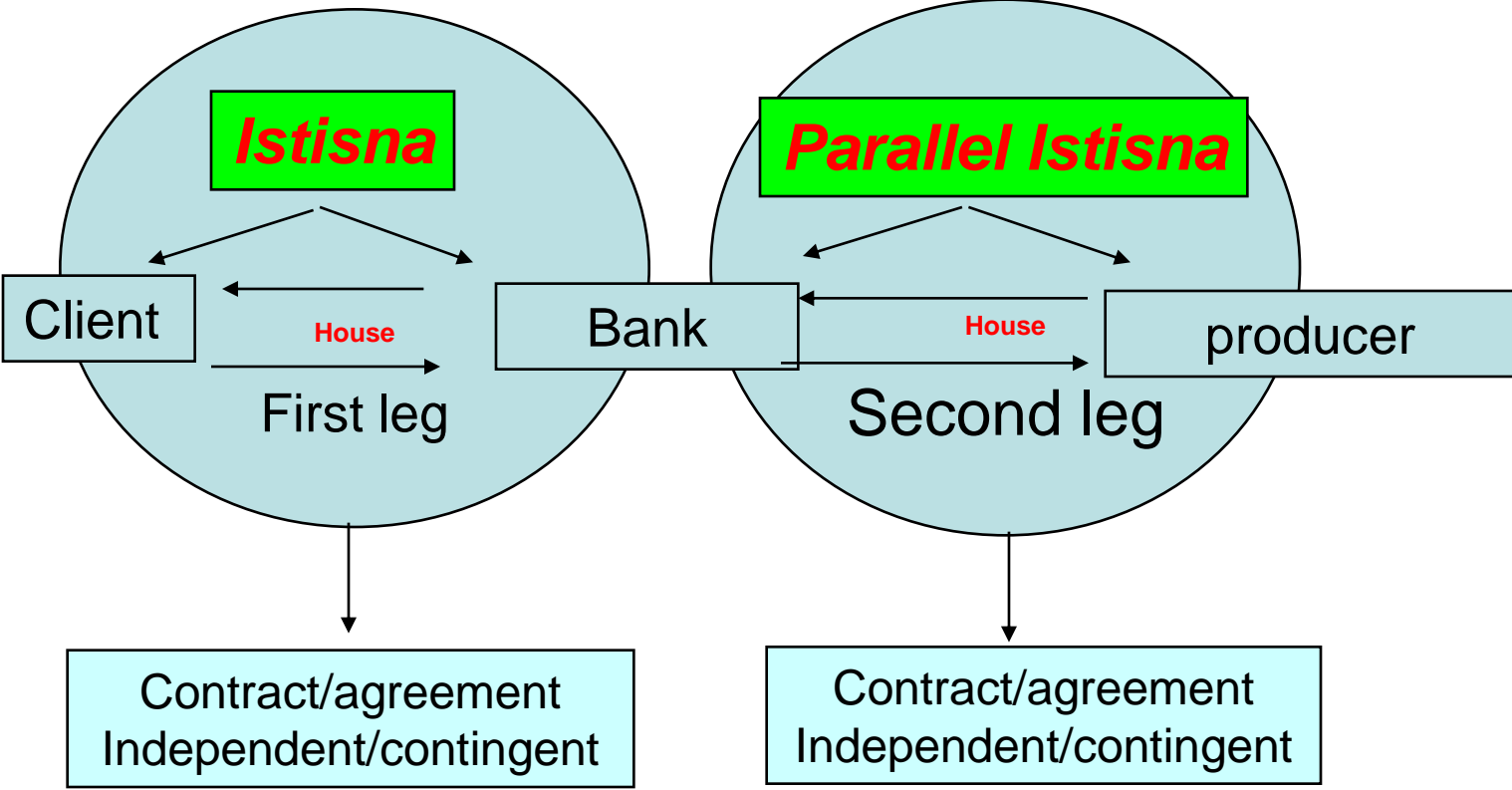


Bai Istisna' (sale by order)

Istisna' means sale on order i.e. the sale of goods by way of ordering where the price is paid in advance or progressively but the assets are manufactured and delivered at a later specified/defined date.

Bai Istisna is permissible according to the majority of jurists. It is reported that the Prophet Muhammad (PBUH) had ordered someone to manufacture a ring for him.

Application of Sale contracts (cont)



CONTRACT OF IJARAH

IJARAH/LEASING

"Ijarah" is lexically means 'to give something on rent'.

فجاءته إحداهما تمشى على استحياء قالت إن أبي يدعوك ليجزيك أجر ما سقيت لنا

“Afterwards one of the (damsels) came (back) to him, walking bashfully. She said: “My father invites thee that he may reward thee for having watered (our flocks) for us.” القصص 28 : 25

فإن أرضعن لكم فأتوهن أجورهن

And if they suckle your (offspring) give them their recompense.” الطلاق 65: 6

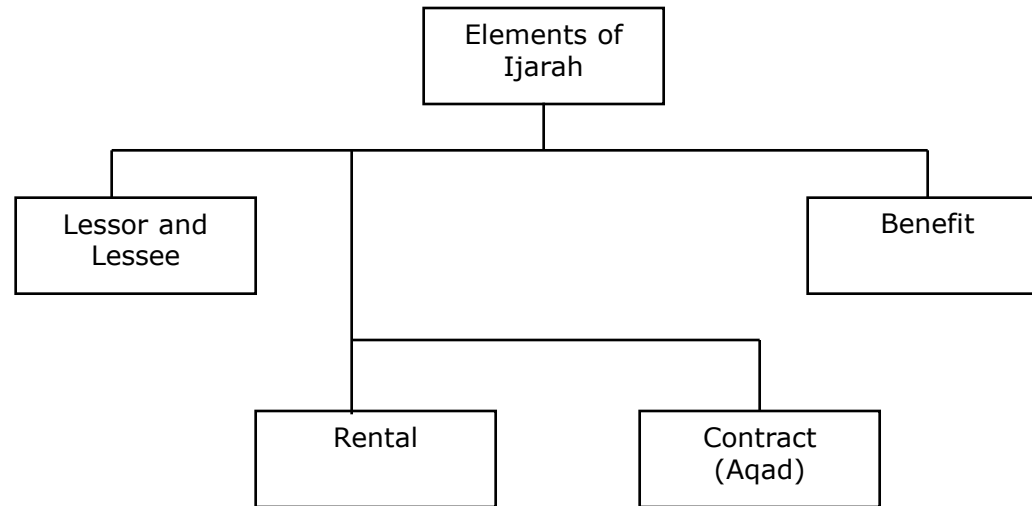
The rules of Ijarah, in the sense of leasing, is very much analogous to the rules of sale, because in both cases something is transferred to another person for a valuable consideration.

The only difference between Ijarah and sale is that in the latter case the corpus of the property is transferred to the purchaser, while in the case of Ijarah, the corpus of the property remains in the ownership of the transferor, but only its usufruct i.e. the right to use it, is transferred to the lessee.

Types of Ijarah

1. In the Islamic jurisprudence, the term 'Ijarah' is used for two different situations. In the first place, it means 'to employ the services of a person on wages given to him as a consideration for his hired services. This type of Ijarah includes every transaction where the services of a person are hired by someone else. He may be a **doctor, a lawyer, a teacher, a laborer or any other person who can render some valuable services.**
2. The second type of Ijarah relates to the usufructs of assets and properties, and not to the services of human beings. 'Ijarah' in this sense means **'to transfer the usufruct of a particular property to another person in exchange for a rent claimed from him.**

ELEMENTS OF IJARAH



2) Contract of Ijarah

(1) and (2) Lessor and Lessee

There are three necessary conditions of lessor and lessee as follows

:

- i. capable of taking responsibility. They must :
 - be of sound mind, i.e. not mad, not mentally retarded, nor a children (aqil)
 - have reached the age of puberty (baligh), and
 - have reached majority (rasheed/ 18 years old)
(able to manage their own affairs)

ESSENTIAL ELEMENTS OF THE CONTRACTS (cont)

- ii. not prohibited from dealing with their property, i. e:
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Note:

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3) BENEFIT (USE OR USUFRUCT)

The necessary conditions of benefit which are:

- i. It must be permissible.
- ii. It can be fixed in value.
- iii. The lessor has the power and capability to provide the benefit and allow the lessee to use the property

Benefit -cont

- It must be owned by the lessor/ or it usufruct must be owned by the lessor.
- It must be ready for use (except for forward lease/Ijarah Mausufah Bizzimmah).
- It must be delivered to the lessee.
- It must be specific by address, description or specification.

iv. It must be specified.

- For a single-purpose property the period of leasing must be known.
- For a multi-purpose property the type of use must also be stated clearly.

v. The benefit must not be a material part of the property (Ibn Taimiyyah allows leasing cow for milk/tree for fruit/ woman for breastfeeding).

4) RENTAL

There are two necessary conditions as follows:

- i. known currency or services or goods
- ii. absolute amount
- iii. It may also be for a fixed or variable amount
- iv. The parties may agree to amend the rentals of future periods.

5) CONTRACT

Contract has three necessary conditions which are:

- i. The offer and acceptance must be in definite and decisive language. It must be in the present or past tense; it must not be in the future tense, imperative or with the words “agree to”.
- ii. The acceptance must agree with the offer.
- iii. The offer and acceptance must be made at the one and the same meeting

FINANCIAL LEASE
VS
OPERATING LEASE

IJARAH MUNTAHIYAH BITTAMLEK

Ijarah Muntahia Bittamleek or Ijarah Wa Iqtina is a form of lease contract that offers the lessee an option to own the asset at the end of the lease period.

Transfer of ownership can be in the following forms:

- (i) Transfer of ownership through gift, i.e. the transfer of legal title for no consideration.
- (ii) Transfer of ownership through transfer of legal title at the end of a lease for a token consideration or other amount as specified in the lease.
- (iii) Transfer of ownership through transfer of legal title prior to the end of the lease term for a price that is equivalent to the remaining Ijarah instalments.
- (iv) Transfer of ownership through gradual transfer of legal title of the leased asset.

IJARAH THUMMA AL-BAI (AITAB)

Ijarah Thumma Al-Bai (AITAB) is one of the categories of lease, which ends with the sale of the asset, where the legal title of the leased asset will be transferred to the Customer upon full settlement or early settlement. AITAB consists of two different contracts:

- (i) Contract of Leasing or Ijarah
- (ii) Contract of Sale or Bai

Juala Contract

Juala Contract

Ju'ala is a contract in which one of the parties (the Jai) offers specified compensation (the Ju'l) to anyone (the 'Amil) who will achieve a determined result in a known or unknown period.

Ju'ala is permitted deeming the determination of the end result to be realised through it as sufficient, and it is not affected by the uncertainty that prevails with respect to the subject-matter of the contract, that is, the work to be done.

It is for this reason that Ju'ala is suitable for activities for which Ijara, which requires that the desired work be clearly specified, is not.

Distinction between Ju'ala and Ijara

Ju'ala is distinguished from Ijara on the following grounds:

- (a) Ju'ala is valid despite uncertainty of work deeming the determination of the required result by the offeror as sufficient.
- (b) Ju'ala does not require acceptance.
- (c) Entitlement to compensation depends on completion of work and delivery of result.
- (d) Ju'ala is valid even if the other party is not known.
- (e) As a rule, Ju'ala is terminable, while Ijara is binding.

The Elements of Ju'ala and its Conditions

The, elements of Ju'ala are: the two parties (the offeror and the worker), the form of the contract and the subject-matter of the contract (the compensation and the work).

The two parties to the contract (the offeror and the worker)

The existence of legal capacity is a condition for both parties to the contract. It is not a condition that the worker be specified, therefore, Ju'ala is concluded by the issuance of an offer directed at the general public.

Any person whom the offer reaches may undertake the work himself or with the help of another. If, however, the worker is specified, it is obligatory for him to undertake the work himself or with the express consent of the offeror through someone under his supervision and control.

The Elements of Ju'ala and its Conditions

5 Form of the contract

The Ju'ala contract is concluded by an offer directed towards a specified worker or towards the general public, irrespective of such an offer being made verbally, in writing or through any other means that indicate an invitation to work and an obligation to pay the compensation. Acceptance of the offer is not stipulated as a condition.

5. The Elements of Ju'ala and its Conditions

The subject matter of the contract (compensation and work)

The subject matter of the contract is the work that is agreed upon through Ju'ala as well as the compensation for the work.

Among the forms of activity that may be agreed upon on the basis of the Ju'ala contract are the following:

- a) An activity that is intended, through the agreement, to produce a result such as the extraction of minerals.
- b) Any information in which the offeror has an interest such as presenting a report or study or the completion of scientific works that realise a result, but in which the extent of the work cannot be determined.
- c) An activity that is intended, through the agreement, to return lost property to its seeker.

The Elements of Ju'ala and its Conditions

The compensation

The compensation should be known, valuable in the eyes of the Shari'a, and deliverable. If the compensation is unknown, unlawful or not deliverable, payment of reasonable compensation becomes binding.

The compensation may be a portion of the object of work in Ju'ala, for instance, a percentage of a debt agreed upon for collection or the right to utilise, for a determined period, a project whose implementation is agreed upon.

THANK YOU

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