



UNIVERSITI SAINS ISLAM MALAYSIA

جَامِعَةُ الْعُلُومِ الْإِسْلَامِيَّةِ الْمَالِيزِيَّةِ

ISLAMIC SCIENCE UNIVERSITY OF MALAYSIA

Legal Aspects of Islamic Finance

LCA4592

DR. ZULKIFLI HASAN

Contents

- Shariah and legal issues on Islamic financial products

Critiques

- El Gamal, (2006) severely criticizes the existing practice of Islamic finance by claiming that IFIs have heavily used ruses in their products and services to circumvent Islamic prohibitions. At this point, he raises the issue of Shari'ah arbitrage that increases the transactional cost which is unnecessary.
- Saleem, (2006) posits that Islamic finance is 'deception' and 'charade'

Cont..

- Balz, (2010: 250) views that Islamic finance is now experiencing a “formalist deadlock” where the industry is more concerned with formal adherence to Islamic law instead of promoting Islamic ethical values.
- Chapra, (2010) and Siddiqi (2007) for instance view that the practice of Islamic finance seems unable to attain its authenticity and share many common similarities with conventional finance

VARIOUS CONTRACTS

- *Uqud Tamlikat- Al-Mua'wadhat and Attabarua't*
- *Uqud Isytirak- mudharabah, musyarakah and muzaraa',*
- *Uqud Tawsiqat-Kafalah, Rabnu and Hawalah,*
- *Uqud Itlaqat- wakalah and tauliah*
- *Uqud Taqyiydat- taflis.*
- *Uqud Isqatat- ibra', muqasah and*
- *Uqud Hifz- refers to wadiah.*

Islamic Banking Products

- Deposit Products
- Financing Products
- Trade Financing
- Card services/ Banking services
- Treasury/Money Market Products

Issue on Ownership

- Beneficial ownership and full ownership
- the bank holds beneficial ownership of the asset (motor vehicle/house), while the customer, having his name in the document of title, becomes the legal owner
- Profits in trading are allowed because they are not free from risks, losses, and uncertainties.

Compensation or Penalty

- **E.g.** Defaulters under conventional hire purchase will be charged 8.0% per annum; while in an AITAB scheme, the compensation for late charges is only 1%.
- **Penalty: Gharamah**
- **Ta'widh: Compensation**
- **Compensation for late payment-**
- **Prior 1998- Cannot impose compensation**
- **Post 1998- Can:-** i. La Darar Wa la Dirar ii. Al-Darar Yuzal iii. Fatwa Al-Zarqa': Bay Al- Arabun iv. Based on economic loss.

Compensation or Penalty

- No penalty.
- 1. once due, become a debt obligation payable by the hirer and are subject to all the rules prescribed for a debt.
- 2. This penalty, if meant to add to the income or generate profit for the owner, is not warranted by the *Shariah*.
- 3. A monetary charge from a debtor for his late payment is exactly the *riba* prohibited by the Holy *Qur'an*

Penalty or compensation

- Penalty is allowed:
- a penalty can be charged to the customer for delayed payment, though the amount recovered is only to be used for charitable purposes by the bank
- BNM: the customer shall pay to the bank the sum equivalent to the costs incurred by the bank in the maintenance on such default amounts or such rate as prescribed by the Bank Negara Malaysia.

Ownership risk and maintenance

- **Ownership risk and maintenance is upon the Lessor.**
- Article 529 Mejele “It is the duty of the lessor to put right things that detract from the intended benefit.”
- **Eg road tax, maintenance, services,**
- maintenance responsibility is undertaken by the customer. *Shariah* scholars held that this condition does not nullify the contract because the practice is based on *'uruf* (local custom) and market practice
- **Call Option and Put Option**
- **CO- Buy the asset PO- Sell the asset**
- **Whether it is lawful in syariah- Lawful**

Takaful coverage

- The general principle enunciates that *takaful* of an asset is the responsibility of the owner.
- eg. AITAB: Takaful is solely upon the hirer.
- the purpose of taking insurance coverage is to protect oneself from any risk related to being a user of the asset. Any damages to the asset or injury to the third party caused by one's own negligence shall necessarily be his responsibility.
- Therefore, it is reasonable for the hirer to take insurance (*takaful*) coverage for the above purposes

Term charges

- **Term Charges under HPA 1967- Interest**
- Term charges are calculated based on a formula set in the HPA and according to the prevailing market rate
- **Eg. RM100K X 5 years x 10% BLR Fixed by the Govt .**
- **This is against the Syariah**

Issue on Bay Dayn

- *Hanafi madhhab* - selling of debt to a third party is not permissible because of the risk cannot be overcome in the context of debt selling.
- *Shafi'i madhhab*- selling of the debt to third party was allowed if the debt was guaranteed and was sold in exchange for goods that must be delivered immediately. When the debt is sold it should be in cash or tangible assets as agreed.

Issue on Bay Inah

- **Shafii-** The contract is valid provided that it complies with all conditions of contract
- **Jumhur-** The contract is invalid. Considered as back door to riba.

Issue on Iwad

- The requirement of *'iwad* (equal countervalue or compensation) in the contract of sale (*al-bay'*) is one of the cornerstone of Islamic theory of profit depicted well by the legal maxim "*al-ghorm bil ghonm*", (no reward without risk) and "*al-kharaj bil daman*" (in any benefit lies a liability).
- cost of inputs 2) market risk and liability and 3) effort or value added
- a selling party must hold all liability arising from all defective goods sold

The issue of attestation

- In 2:282. Debt+ in writing+ 2 male witnesses
- The requirement of 2 male witness is just attestator and not considered as witness.
- It is not compulsory but Islam encourages it.

Underlying Asset

- Lawfulness-
- Q= Building is Islamic but the purpose of constructing it is not Islamic
- Free from any encumbrances
- Issues on new form of asset e.g
concessionary rights, copyrights, trademarks

Clause on Right to Recall the Facilities

- **Event of default- Bank may recall or terminate.**
- **Permissible= Muslim is bound by his promise**

Issue on Ibra

- A rebate, or *ibra'*, can be given for early settlement
- In the 101st Meeting on 20 May 2010, the SAC issued:
 - (i) BNM as the authority may require the IBIs to accord *ibra'* to their customers who settled their debt obligation arising from sale-based contract prior to the agreed settlement period;
 - (ii) BNM may also require the terms and conditions on *ibra'* to be incorporated in the financing agreement to eliminate any uncertainty with respect to the customer's entitlement to receive *ibra'* from the IBI; and
 - (iii) The *ibra'* formula will be standardised by the BNM.

Debt Financing vs Equity Financing

- Economist- Criticize the players for depending much on the instrument based on debt financing.
- Not truly Islamic. It does not represent actual difference with conventional banking system.
- Practitioners, Legal and Syariah Scholars- Both represent their functions and meet the market needs.

Cont..

- Siddiqi, (2004) points out his concern about the existing practice of Islamic finance in which too much focus and reliance on jurisprudence and little weight given to the scientific aspects of the discipline
- Asutay, (2008) maintains that the Islamic finance has failed to realize the very reason of its existence in providing socio-economic development for the larger parts of the Muslim world and communities. He further criticizes that IFIs do not serve and engage with communities but rather to serve markets (Asutay, 2010: 43).

Issue on the sequence of transaction

First Structure	Second Structure	Third Structure
<ul style="list-style-type: none">■ Letter Of Offer■ PPA■ PSA	<ul style="list-style-type: none">■ Letter of Offer■ PPA■ PSA■ Facility Agreement	<ul style="list-style-type: none">■ Letter of Offer■ Facility Agreement■ PPA■ PSA

S 66 BAFIA

- Bank cannot acquire shares of immovable property.
- IB involves with buying and selling of properties.
- Solution- S 116 (2) (a)- BNM's supervision

S 55 of the IBA 1983

- IBA prevail over Companies Act.
- What about other acts?
- The IBA silent on this aspect.

Court Jurisdiction

- Banking and finance under the federal list
- Only person profess Islam- Shariah Court
- IB is a company established under the Co. Act.

Real Property Gains Tax Act

- **Any transfer of ownership- pay the tax.**
- 10% be applied to properties held and disposed of within two years.
- A rate of 5% for properties sold within the third, fourth and fifth years after purchase.
- **Eg. BBA transaction will trigger double taxation since it involves 2 transactions.**
- **The govt amended the RPGT- One taxation only**

Stamp Duty

- **Every transfr of property- Stamp Duty.**
- **Ad valorem:** a tax based on the value of real estate or personal property
- **Nominal:** fixed eg. Duplicate or counterpart
- **The govt amended the stamp duty act 1949**

Thank You

Zulkifli Bin Hasan

Faculty of Syariah & Law

E-mail: zulkiflih@admin.kuim.edu.my

E-mail: zul361977@yahoo.com

Tel. No: 06-7988455

H/Phone No: 016-3379776