

Why in Favor of Tawarruq not Bai' Al-Inah in Personal Financing Product?

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Abstract

In view of the limited of study with regards to the concept of Bai' Al-Inah and Tawwaruq on personal financing, the findings from this study would provide evidence on the understanding of the two concepts, and to determine whether there exists elements of Riba or otherwise in the present medium of personal financing. In addition, the findings of this study can provide a premise whether Tawwaruq is a solution to Bai' Al-Inah in personal financing offered by Islamic banks and financial institutions or otherwise. Further, the outcomes may also have some policy implications whereby the policy made can suggest the adoption of Tawwaruq or Bai' Al-Inah as a best solution to Riba-based personal financing.

Keywords: Islamic Banking System; Tawarruq; Bai' Al-Inah; Personal Financing

1. Introduction

Today, the number of Islamic banks and the financial institutions are increasing. New Islamic banks with large amount of capital are being set-up. Conventional banks are opening Islamic subsidiaries for the operation of Islamic banking. Even the non-Muslim financial institutions are entering the field and trying to complement each other's businesses in order to attract as many Muslim as well as non-Muslim customers. Therefore, it seems that the size of capital of Islamic banking will be multiplied in the next decade and the operations of Islamic banks are expected to cover a large area of financial transaction of the world (Wafa, Nasri, & Hazim, 2003; Usmani, 2002). Although there are differences between Islamic banking system and conventional banking system; there are some similarities between the two. For example, an Islamic bank conducts its activities in accordance to the *Shariah* principle that strictly prohibited any payment or receipt of interest (*Riba*). Additionally, the Islamic bank can also offer products and services which are similar to those offered by a conventional bank (Haron, 2005; Yakcop, 1996). The difference mainly lies in the manner the banking transactions are conducted and the way money is mobilized and recorded. Islamic banks are offering a wide range of Islamic financing products and one of which is personal financing. While personal loan in conventional banks is interest based, personal financing in Islamic banking adapts the principle of *Bai' Al-Inah* (Sabran, 2000; Shamsuddin, 1995).

According to Saiful Azhar and Azizi (2003) *Bai' Al-Inah* is permitted by the Shafie' School of *Fiqh* and it is widely used in many banking facilities such as personal financing. With global markets, the requirement for the product to be globally accepted is no longer an option but a must. It is worth to mention that international Islamic portfolios fund managers are generally advised by Middle-Eastern Muslim Jurists (*Fuqaha'*) most of whom belong to the Maliki, Hanbali, and Hanafi schools of *Fiqh*. Thus, it is critical that Islamic financial instruments are designed to attract these investors as well. Insisting on a *Shariah* standard based on one school of *fiqh* alone may not be of interest as this may isolate the respective country from global Islamic finance. According to Ali (2006), *Tawarruq*

is the sale that is comprehensive as it examines the kinds and forms and it current practiced by Islamic and commercial banks and financial institutions. This sale has become one of the important transactions used by banks to enable their customers to get liquidity.

2. Strategic Issues

Islamic *Muamalat* does not only provide different varieties of banking products but also provides new business environment to customers. However, to what extent does this product will be able to contribute to the growth in Islamic banking system? Since the study of personal loan has evolved extensively in conventional banking, it is of great interest to study the personal financing involving Islamic model.

The problem is inherent in the present personal financing offered by Islamic banks in perplexity surrounding the concept of *Bai'Al-Inah*. Certain group of scholar's opinion is that personal financing based on *Bai'Al-Inah* concept is still having the element of *Riba*, while certain scholars approve the usage of *Bai'Al-Inah*. This question motivates the researcher to find out the reasons behind these two different opinions. In addition, another emerging thought is *Tawarruq* is a better model than *Bai'Al-Inah* in personal financing. Hence, this study also aims to find out the issue of *Tawarruq* as personal financing.

3. Shariah Rules in Islamic Banking System

According to the Central Bank of Malaysia (2005), Islamic banking has the same objectives as conventional banking except that the former operates based on *Shariah* principles known as *Fiqh Al-Muamalat* (Islamic rules in business transaction). The basic principle of Islamic banking is profit and loss sharing and prohibition of *Riba*. Among the model commonly used in Islamic banking are profit and loss sharing (*Mudharabah*), agreement sell and buy back (*Bai'Al-Inah*), deferred sale (*Bai' BithamanAjl*), joint venture (*Musharakah*), cost-plus (*Murabahah*), and leasing (*Ijarah*).

In Islamic banking operations the Islamic laws are very important. For instant, personal financing is not referred to as interest charged but it is referred to as business transaction and goods trading serve as a basis for financing arrangement. On the other hand, the conventional banking system which is interest based, the debtor has to pay the principal plus the interest for any loan applied (Azhar&Sanusi, 2003). This problem of interest has been studied for sometimes and there are a lot of solutions to choose from which are permissible by Islamic laws. For example, *Bai' Al-Inah* concept has been introduced to overcome the interest based personal loan. Besides *Bai' Al-Inah*, *Tawarruq* is relatively new and only a few Islamic financial institutions have implemented *Tawarruq* as their personal financing product (Azahari, 2013; Mohd Farihal, 2007).

4. A Review on Riba

According to Muhammad Ayub (2007), effort has been made to ascertain what constitutes *Riba*. Any increase over the principal amount of a loan or debt against nothing but time is *Riba*. As a logical corollary to the prohibition of *Riba*, the *Shariah* has prohibited all benefits accruing to a person without any labor, risk or expertise. Any person who wishes to earn profit on his monetary investment must bear the loss or damages accruing to the business where his money capital has been used. A number of verses of the Holy Qur'an expressly prohibit *Riba*. For example, Surah al-Baqarah, verses 276-279:

“Allah deprives *Riba* of all blessing but blesses charity; He loves not the ungrateful sinner.”
(276)

“O, believers, fear Allah, and give up what is still due to you from *Riba* if you are true believers.” (278)

“If you do not do so, then take notice of war from Allah and His Messenger. But, if you repent, you can have your principal. Neither should you commit injustice nor should you be subjected to it.” (279)

Additionally, the following Hadiths of the holy Prophet Muhammad (pbuh) reiterate the prohibition of *Riba*: From Jabir (Gbpwh): “The Prophet Muhammad(pbuh) cursed the receiver and the payer of interest, the one who records it and the witnesses to the transaction and said: They are all alike [in guilt].”

From Anas ibn Malik (Gbpwh): “The Prophet Muhammad(pbuh) said: „When one of you grants a loan and the borrower offers him a dish, he should not accept it; and if the borrower offers a ride on an animal, he should not ride, unless the two of them have been previously accustomed to exchanging such favors mutually.”

Riba means extra and there are two major types of *Riba*. The first type of *Riba* is *RibaDuyun* which can be further sub-divided into *RibaQardh* and *RibaJahiliyah*. The second type of *Riba* is *RibaBuyu* which can be sub-divided into *RibaFadhl* and *RibaNasiah* (Muhammad Ayub, 2007).

4.1 Types of *Riba*

- *Riba Duyun*

RibaDuyun is the extra amount of money over and above the principal of the loan either, imposed by the lender upon the borrower in the contract or promised by the borrower in the contract. *RibaDuyun* can be sub-divided into *RibaQardh* and *RibaJahiliyah*. *RibaQardh* is effective from the beginning of the transactions on the other hand *RibaJahiliyah* is only effective after the payment is default and there is no *Riba* at the beginning of the transactions. This type of *Riba* occur out of an exchange between two *ribawi* materials of the same kind where the necessary rule(s) are not observed. There is no *Riba* in trading transactions where a *ribawi* material is exchanged with a *non-ribawi* material like money with a car; or a *non-ribawi* material is exchanged with another *non-ribawi* material like rubber with a refrigerator.

- *Riba Buyu*“

RibaBuyu’ can be sub-divided in two types, *RibaFadhl* and *RibaNasiah*. *RibaFadhl* i.e. the *ribawimaterials* (of the same kind) exchanged is of different weights, measurements or numbers and they are exchanged at the same time. On the other hand, *RibaNasiah* or *RibaYad* i.e. the *ribawi* materials exchanged are of equal weights, measurements or numbers but payment of the price and delivery of the goods are made at two different times.

Islamic banking does not give out loans. Therefore, *Riba* out of lending and borrowing does not arise. To avoid involvement with *Riba* in trading transactions, Islamic banking must pay proper attention to the requirement that the buying and selling of the following matters must be on cash basis:

- a. Gold in treasury functions for liquidity; and
- b. Silver in treasury functions for liquidity, and currencies, the currency of each country being considered as a kind, for hedging and payments of imports.

Principle of jurisprudence is a principle recognized by *Shariah*. It is made by scholars to facilitate the process referring to the *fiqh* problems based on *Shariah* principle (Abu Ghuddah 1992:129).

5. A Review on *Bai’Al-Inah* and *Tawwaruq* Practice

Bai’Al-Inah is an act of selling subject matter and then repurchase it back with lower price (Ibn Qudamah 1408H: 26). Although it appears that a consensus on *Bai’Al-Inah* has been made the view of *Shariah* scholars do differ, especially when the requirement for the product to be globally viable and accepted. This is due to fund managers of international Islamic portfolios are generally advised by Middle-Eastern Muslim jurists (*fuqaha*“), most of whom belonging to Maliki, Hanbali and Hanafi schools of *fiqh*. Therefore, it is important that Islamic financial

instruments (such as *Tawarruq*) are designed to attract these investors as well. Insisting on a *Shariah* standard based on one school of *fiqh* alone may not be good as this may isolated the respective nation (i.e. Malaysia) from global Islamic finance (SaifulAzhar and Azizi, 2003).

5.1 The Practice of Bai' Al-Inah

According to Azahari (2013), *Bai' Al-Inah* is defined as a sale with immediate repurchase. It involved the sale and repurchase transaction of an asset by a seller (Islamic bank). In the first transaction, a seller sells his or her assets to a buyer on credit (deferred price). Subsequently, in the second transaction, the buyer resells the same assets back to the seller on cash term at a lower price than the deferred price. Therefore, the transaction amounted to a loan. The difference between the two prices represents the interest (*riba*). Such contract was evolved in the early period of Islam and it exists for the fundamental reason that a loan for interest is forbidden because it is equivalent to *riba (usury)*. In this contract, there is an economic interest for both parties (lender and borrower), which at the same time circumvents the prohibition of *Riba* or *usury*.

The personal financing used by Islamic bank based on repurchase or *Bai' Al-Inah*. A Murabaha financing can be converted into *Bai' Al-Inah* if the identity of the vendor is not different from its client, when the bank purchases a commodity from its client on a spot basis and sells it back to the client at a cost-plus price and on a differed basis. The rate of profit in this case is indistinguishable from prohibited *riba* in a conventional personal loan. For example, when a seller (Islamic bank) sells the asset to a customer on a deferred basis and later the seller will repurchase the same asset on a cash basis at a lower price than the deferred price (Mohd Farihal, 2007). The following Figure 1 depicted the *Bai' Al-Inah* personal financing modus operandi.

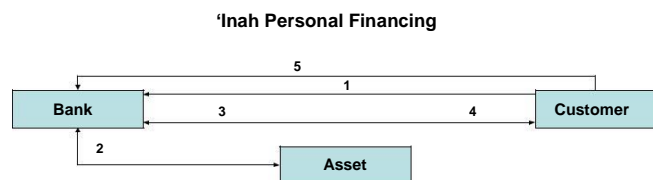


Figure 1: *Bai' Al-Inah* Personal Financing Modus Operandi

The *Bai' Al-Inah* personal financing modus operandi:

- The customer approaches the Islamic bank for financing.
- The bank identifies the asset that will be traded under *Bai' Al-Inah* contract.
- The bank and customer sign a first sales and purchase contract where the Islamic bank sells the asset at a selling price (financing amount plus profit margin) on deferred terms and the ownership is transferred to the customer.
- The bank and the customer sign a second sales and purchase contract where the bank buys back the asset sold to the customer at a cost price and pays on cash basis.
- The customer begins to pay his installment to the bank (Azahari, 2013; ISRA, 2011).

According to Mohd Farihal (2007), there are differences in scholar's opinion on ascertaining the *hukmon* the *Bai'Al-Inah* model in *Muamalat* transaction. Here, the issue is how *Shariah* views such contract and what is the *hukm* to solve the implementation of *Bai'Al-Inah* model in Islamic personal financing?

According to Shafi'i and Ibn Hazm, such sales are to be allowed, but abhorrent, with certain conditions and do not involve *Riba*, uncertainties and gambling. Their reason is that *Bai'Al-Inah* contract has satisfied all the requirement of a valid contract. The intention of the contracting parties has no effect on the validity of the sale. The intention is not considered since there is no means to know it, unless intention is expressed explicitly (Abu Ishaq). In the Shafi'i and the Zahir schools of *fiqh* only external intention of the contracting parties is to be considered. Thus, *Bai'Al-Inah* is valid on the basis of the verse: "Allah has allowed the sale and purchase and has forbidden the interest." They do not address the succession of two contracts of sale as sufficient evidence to prove the existence of a *ribawi* intention (Ibn Hazm). In addition, Abu Yusuf from Hanafi School considered this sale as valid without abhorrence, and Muhammad ibn al-Hassan al-Shabani had a slightly different view. He perceived this sale as valid with abhorrence.

However, Maliki, Hanafi, Hanbali, and Ibnu Taimiyah declare that the contract is void, *haram* and *sinful*, for such a transaction is *Riba* or smacks of *Riba* (*shubahat*). They argue that the form of the contracts of sale in "*Bai*" are nothing but a legal device or a legal fiction (*hilah*) to legalize what is intrinsically illegal by *Shariah*, as they classify "*Bai*" in the essence, a loan with interest. They base their objections to the validity of "*Bai*" on the following.

- It is an uncalled for *hilah* as mentioned above.
- The presumed wrongful intention (*niat*) to commit *Riba* transaction, in line with the hadith which says "all actions are judged by intention."
- The reported of famous incident narrated by Imam ad-Daruquthni and al-Bayhaqi from Abu Ishaq, from his wife Aliyyah discovered that it was from Sayidatina Aisyah, UmmulMukminin together with Umm Walad Zaid ibn Arqam and another women. Umm Walad Zaid said, I used to sell slaves to Zaid costing 800 dirhams with deferred payment and I bought back (the slaves) at the price of 600 dirhams on cash. Sayidatina Aisyah said, it is not a good way to sell and buy. Tell Zaid that he is cancelling his reward of *Jihad* and *Hajj* along with Rasulullah unless Zaid repents!

The above view is based on the report of an incident between Zaid Abu Arqam and Sayidatina Aisyah. Jurists supporting the *Bai'Al-Inah* sale also apply analogy (*qiyas*) on the means/expedients (*dhara'i*) but this is prohibited and constitutes the motive of the contract. They concluded that the *Bai'Al-Inah* sale is a mechanism to legalize *Riba*. Anything that can be used as a means to commit a prohibited is prohibited (Mohd Farihal, 2007).

Further, Abu Hanifah claims that this contract is void (*batil*) if it does not involve a third party, who either deals with the original seller or buyer. However, Abu Hanifah in this case appears to have changed his previous opinion in which he concluded that the *Bai'Al-Inah* sale is *sahih*.

Based on the above discussion, we can conclude that the objection on the validity of *Bai'Al-Inah* is based on the following reason:

- It is a legal device (*Hilah*).
- The presumed wrongful intention to commit *Riba* transaction. This is explained by the *hadith* which say "all actions are judged by intention": Zaid ibn Arqam.
- The reported opinion of Aishah against Zaid ibn Arqam.
- The reported *sahih* hadith narrated by Ibnu Umar.

However, *Al-Shafie* rejected the *hadith* regarding Zaid ibn Arqam and Aishah, saying that the *hadith* is not established (*Thabit*) for the following reasons.

Aishah’s condemnation of the *Bai’Al-Inah* sale is based on the view that the payment on the sale is deferred into some unknown or unspecified period. Sale with deferment in payment is not valid. The incident involved two companions and if there are disagreements between the companions, *Shafie* methodology is to take the opinion of whom we can use analogy (*qiyas*) with. In this case it is on Zaid said. In other word, while it is clear that Zaid acted contrary to the meaning of the *hadith*, this does prove that the companions themselves were not of the same opinion. When this happens, analogy (*qiyas*) is applied (ISRA, 2011; Muhammad Ayub, 2007; Mohd Farihal, 2007).

5.2 The Practice of *Tawarruq*

According to AAOIFI *Shariah* Standard (2006), *Tawarruq* is the purchase of a commodity on deferred payment basis by way of either direct sale or *Murabaha*. The commodity is then sold for cash to a party other than the original seller. Further, Engku Rabiah claims that *Tawarruq* has been generally used to refer to an agreement whereby a person who was in need of cash bought some goods for deferred payment and then sold the same goods to another party (not the original seller) for cash payment at a lower price.

According to ISRA (2011), *Tawarruq* is a *Shariah* compliant financing method, with which you can raise financing through buying installments in a local commodity, owned by the bank. The applicant then authorizes the bank to sell his share in this commodity on his behalf to a third party for cash and then deposit the proceeds into his account. Further, *Tawarruq* can be defined as an arrangement that involves a purchase of an asset based on *musawamah* or *murabahah* and a subsequent sale of the same asset to a third party in order to get cash money. For example, one party buys a commodity on credit term at a mark-up price and sells the same commodity at a lower price to a third party to get cash. The end result of this transaction is that, the customer obtaining cash to be used for his or her personal needs or business (ISRA, 2011). The following Figure 2 depicted the *Tawarruq* personal financing modus operandi.

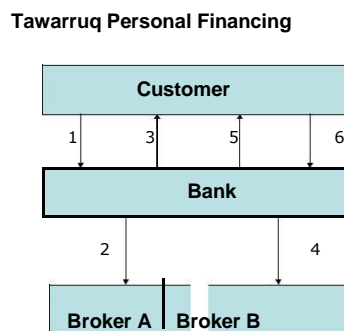


Figure 2: *Tawarruq* Personal Financing Modus Operandi

The *Tawarruq* personal financing modus operandi:

- The customer and the bank (Islamic bank) enter into an arrangement where the customer promises to buy a commodity or asset from the bank. The customer at the same time appoints the bank as his agent to sell the said commodity or asset.
- The bank buys a commodity or asset from Broker A on a spot basis.

- The bank sells the same commodity or asset to the customer on deferred basis at cost plus profit.
- The bank as an agent to the customer sells the same commodity or asset to Broker B on a spot basis.
- The bank pays the customer the sale proceeds in a lump sum basis.
- The customer pays the bank the purchase price of the commodity or asset on a deferred installment basis (Azahari, 2013; ISRA, 2011).

Shariah View on Tawarruq Transaction

Here, the issue of concerns is how Shariah views such contract *Tawarruq*. Differences of scholar opinion on ascertaining the *hukm* on the concept of *Tawarruq* in transaction are as follow.

- The Jumhur, Hanabilahand Shafie“ View: According to Al-Zarkashiyy (1982), *Tawarruq* is generally permissible. Their reason: “*Allah has allowed the sale and purchase and has forbidden the interest.*”
 - ✓ Sell subject matter to third party
 - ✓ The Prophet Muhammad (pbuh) said in work: “*The sale of large amount of dirham and sale of dirham janib have no element of TawarruqRiba. It is a sale and purchase transaction.*”

The Ibn Taymiyyah (2005) and Ibn Qayyim (1973) view: *Tawarruq* is generally disallowed. In fact, they are strongly against the practice and consider it as fraud against *Allah* and *Shariah*. Ibn Taymiyyah“s reason: “*Verily, the Prophet Muhammad (pbuh) has forbidden selling while in urgent condition.*”

6. Conclusion

Both *Tawarruq* and *Bai' Al-Inah* are interest free (*Riba* free) models as prescribed in the application of *Bai' Al-Inah* principle and *Tawarruq* principle. Islamic personal financing uses the method that is accepted by Shariah Advisory Board (SAB). There are Islamic scholars who support the practice of *Bai' Al-Inah* and *Tawarruq* in Islamic personal financing as the best alternative for avoiding *Riba*. The transaction using *Bai' Al-Inah* and *Tawarruq* has several differences. The *Bai' Al-Inah* involves two (2) parties in completing each transaction whereas the *Tawarruq* involves three (3) parties. The purpose of *Bai' Al-Inah* and *Tawarruq* are the same but the way the *Hilah* is practiced is different. *Bai' Al-Inah* has many *Hilah* (the way the transaction performed is like buy and selling transaction although the purpose is for money lending). On the other hand, *Tawarruq* has less *Hilah*. Based on the model and study done by Azahari (2013) and Mohd Farihal (2007), *Tawarruq* is really needed and should be introduced into the market such as Malaysia, as *Tawarruq* promotes a better Islamic banking practice.

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