# *A technical analysis of the Murābaḥah*
# *[or Cost plus / Mark up]*
# *Financing technique as applied by Islamic Banks.*

**Version 1,000 Wednesday, September 19, 2007**

**Prepared and Delivered**
**by**
**Ustadh, Ahmed Fazel Ebrahim**
**Mayfair, Johannesburg, South Africa**
**(Graduate of: Madrasah Arabiyah Islamiyah, Azaadville, South Africa)**

**at the "Understanding Islamic Finance" Conference**
**19th and 20th September 2007**
**hosted by Financial Events International**

Ramada Park Hotel ★★★★★

Geneva, Switzerland

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**Bismillāh-ir Raḥmān-ir Raḥīm**

In the name of Allah, the Extremely Merciful, the Most Compassionate

## Introduction

The primary teachings and beliefs of Islam are the same but there is much juridical diversity in the interpretation of specific canons of Islamic Law due to which the same multitude of differences find reflection in Islamic contract law. This then also subjectively and objectively flows into the contracts drafted and applied by Islamic Banks. These differences have advantageously allowed for some degree of flexibility in the contracts although the very same differences could negatively impact the validity of an Islamic contract if not judiciously applied.

Due to the diverse theories formulated for the interpretation of the Quranic verses and prophetic sayings, the jurists who codified and formulated Islamic law have often differed on some point or the other. Such differences require to be resolved by senior scholars of the Muslim world in order to allow for a coherent application of Islamic banking contracts. There would of course be regional differences or preferences and, in some instances, allowance for adopting one of the alternative view points provided this is also possible to implement within the civil law of national states.

Accurate translations of Islamic legal texts would help non-Muslim and non-Arabic speaking Muslim professionals to gain further insight into the depth of Islamic contract law. Serious errors in the translation of Islamic Edicts or material used as a basis for such edicts as well as errors in the understanding and interpretation of secondary sources of Islamic law has been a cause of much misunderstanding due to which many persons have incorrectly formulated their writings on the subject and also inferred incorrect opinions which violate the spirit of Islamic Law.

As, Muslims, we cannot deny that non-Islamic legal systems have flourished and embody unique developments within the subject and body of law. Much of the latter would not necessarily be un-Islamic or alien to the diversity of principles in Islamic law. Muslim scholars require a re-framing of their legal thought in order to re-draft some of the earliest writings on Islamic Law. In this regard, I must emphasize that a new body of Islamic Banking Law and collations of case law from Islamic banking operations require immediate attention.

Many rules in the primary sources of Islamic Law govern a sale contract. The verses of the Quran and prophetic traditions have been furthered interpreted by Muslim jurists on the basis of a detailed but complex network of interrelated theories. Resultantly, their inferential analysis were included in the body of Islamic jurisprudence. Although, these rules authoritatively define Islamic trade contracts, there is some degree of allowance in particular cases for re-analysis of the same or for adopting one of the alternative Islamic rulings due to contingencies or necessity.

A large base of fatawa (Islamic edicts) have been compiled and written by members of the religious supervisory boards of Islamic banks, and also by other Muslim scholars. Some of these are available on the net or in printed sources and serve as invaluable guidelines on the technical matters surrounding the various clauses of Islamic trade contracts. Unfortunately, much of the material is in Arabic, and pathetically, some of the material has been badly translated into English. It should be noted such edicts do not always represent the final word of Islamic Law, and sometimes, these edicts could even be wrong or impartial in favour of

one of the many juridical opinions on the matter. Resolving this requires a thorough analysis of all the authoritative opinions of the earliest of Muslim jurists and scholars. Nevertheless, these edicts do have persuasive influence and authority especially when these are written be senior Muslim jurists who have backed their views and analysis with evidence from the primary and secondary sources of Islamic law.

Substantiating evidences from the sound and authoritative sources of Islamic law is absolutely necessary to support viewpoints expressed regarding issues in contracts and, on an overall basis, to attribute the contract as Islamic. It is not necessarily the opinion or status of any Muslim jurist that renders a contract valid, rather it is the soundness of the Islamic sources he has used or the legitimacy of the inferences he has made on the contents of such sources which would grant credence to the validity of an Islamic financial contract.

Besides the religious sources; the spirit of fairness, justice and mutual agreements which do not infringe the precepts of Islam play an important role in the formulation of an Islamic contract.

Historically, the Murabahah contract was a simple contract where the seller sold an item on cash or credit but specified his exact or total cost together with negotiating the percentage or amount of profit that he wanted.

The declaration of the cost was done on the basis of trust with the understanding that Allah/God is witness to the honesty of the trader. If the trader was dishonest, the client's belief in the Hereafter and in Allah/God was generally sufficient for the execution of justice. The declaration of the cost also allowed the prospective purchaser the ability to better evaluate the article's economic worth due to which he either accepted, rejected or re-negotiated the price that he was wiling to pay for that commodity. In this sense, the purchaser could attempt to negotiate a lower price if he realized that the seller had paid much less for the asset/commodity although the fair current market value was much higher. On the other hand, it also somewhat protected the consumer against extreme and unjustified levels of profits.

Islamic banks use an altered form of the **Murābaḥah** contract to facilitate the financing of short-term and long-term trade transactions according to the end users' requirements.

The contemporary Islamic banking format of applying the **Murābaḥah** contract is neither an independently applied contract since all other associated Islamic trade rules either form pre-requisites or essential components to the contract.

In fact, some of the rules specified by Muslim jurists in regard to this contract do not seem to emanate from the prophetic traditions but rather indicate to be the result of a communal norm set over a period of history. Where such rules do not have a basis in the primary sources of law, it would allow for the application of alternative opinions which do not infringe other rulings and the spirit of the Shariah (Islamic law). The existence of this contract could rather be classified as pre-Islamic but sanctioned and governed by other Islamic trade rules.

The amalgamation of these rules are then redesigned, without eliminating the Islamic requirements, to fit into civil financial regulations of non-Muslim or secular Muslim states which have or have not allowed for the application of such Islamic contracts. It is thus that you would get examples of the sale of a vehicle or other asset to be, instead, financially designed as a lease contract purely because the Islamic contract could not be practically concluded by the bank or because of tax or some other implications.

Many Muslims and non-Muslims regard the current banking format of applying the **Murābaḥah** contract as no different to an interest-based loan. They consider this Islamic banking contract as placing another label upon a transaction that is, in essence, no different from an interest transaction. This opinion is not entirely untrue. However, there is common ignorance on the salient differences between the two forms of transactions. Furthermore, people are unaware of the Islamic legal theories which cater for alternative rulings in changing circumstances. The latter has been **one of the main reasons why some Muslim jurists allowed and sanctioned the application of the Murābaḥah** contract as applied in Islamic Banking.

**1. Definition of an Islamic sale contract**

Defining a sale contract is essential to the definition of the Murābaḥah contract since the latter is essentially classified as a sale contract in Islamic Law. Thus all other primary Islamic rules pertaining to sales would be a pre-requisite for its conclusion. Also, all the implications and consequences that evolve from the contract of sale would necessarily also apply to the Murābaḥah contract.

However, the difference between the primary Islamic format of a Murābaḥah contract must be noted against the formats in which it is applied through Islamic banks/ windows. The other associated or consequential clauses related to the Murābaḥah contract stem from the nature of the financed assets, the format of financing and essential legal clauses.

**2. Some Basic Rules of Sale:**

The Shariah defines a sale as 'the exchange of an item of value for another item of value with mutual consent with the provision that the items of value are considered to have value in the Shariah'.

The following are only some of the rules applying to a sale:

1. The object of sale must physically exist at the time of sale.

1.1 A non-existing/abstract thing cannot be sold. Many contemporary Muslim jurists have excluded abstract rights like copyrights, intellectual property, etc. from this.

Other abstract rights like the purchase and sale of warrants are not Islamically acceptable since no material value is acquired by purchasing the right to buy a share at a given price.

2. The object of sale must be in the ownership of the seller at the time of sale. The sale of anything before acquiring ownership is invalid.

This is the very reason why selling shares/stock before gaining ownership is impermissible.

3. The object of sale must be

a) in the physical possession of the seller or the seller should be assumed to have already validly taken possession thereof from the person (juristic or otherwise) from whom the seller had purchased the object of sale.

e.g. **A** has purchased a car from B. B has not yet delivered it to **A** or to **A's** agent. A cannot sell the car to C. If he sells it before taking its delivery from B, the sale is invalid.

An edict used by Kuwait Finance House gives an allowance to sell goods in ownership which are at risk of getting destroyed on a cargo carrier or transportation vessel.

Although the above contract has been allowed, it is disapproved since

1. Risk of non-delivery
2. The possibility of the commodities in the containers not conforming to the Bill of lading and other necessary documentation in which a detailed description of the goods are given.
3. On an economic level, such a transaction leads to the escalation of the cost of the goods before these even reach the consumer market.

A commercial practise in the city of Madina following the era of the prophet and his companions is indicative of the allowance to sell a commodity (food or non-food) in your ownership to a client who has a full description thereof although such an asset is not in your possession at the instance of the contract. This practise seems to be against the implication of another authentic hadith (prophetic tradition) which states "do not sell that which you do not have". However, this practise in the city of Madina, according to the jurist, Imam Malik, indicates towards the fact that this hadith does not refer to an absolute obligation upon the seller to have his sale items directly before him at the instance of the contract if these are fully describable and deliverable provided that these are in his possession. This record of Imam Malik relating to the practise in Madina cannot be used as a basis for allowing the sale of goods yet in freight or sea since not only is the risk of non-delivery is possible, even though the prospective purchaser be willing to accept such risks and may be aware of the insurance on such goods but also because the factor of deception (Gharar) may be highly prevalent in such a contract especially in our era where the levels of honesty are extremely questionable.

b) in the constructive possession of the seller.

"Constructive possession" refers to when the owner has not taken physical delivery of the commodity but has control thereof since all the rights and liabilities, including the risk of its destruction, are passed on to him.

4. The seller must bear the risk of any possible economic loss on the commodity prior to its sale.

Imam Ahmad bin Hambal limits the requirement/need to bear risk to food items that the seller has not yet taken into possession. However, his view is overruled by a hadith which regards ضمان (liability and risk of loss) as essential.

5. There should be no Gharar (possibility/probability or certain deception) in the contract.

6. A hadith in Sunan ul Baihaqi Al-Kubra indicates to the right of a person who has purchased an unseen product to cancel the contract after seeing it.

This is inferred from a tradition that is weak due to some factor or the other but its implications protect the interest of the consumer. Thus, such a right is valid and should be adopted.

7. There should be no non-refundable deposits (unless such deposits were offset against justified costs that the bank incurred due to the client).

8. Although the general traditions prohibit sales with associated conditions, the very nature of many contemporary products and assets demand the imposition of specific conditions on the buyer or obligate both the buyer and the seller to fulfill certain conditions. These are acceptable provided that this is fairly done and for the mutual interest of both the contracting parties.

9. The price must be fixed

**3. Primary Definition of the Murābaḥah contract in terms of Islamic Law**

1. The primary form of a **Murābaḥah** contract is where the owner of a commodity/asset directly sells the same on cash or credit in return for profit (or mark-up) with the provision that the owner specifies what such an asset actually cost him or what it totally costs him after adding all acquisition or other justifiable costs.[1]

   The general nature and objective of all sales is to profit in order to fulfill other economic needs. The same happens here with the exception that the cost of the commodity has to be necessarily disclosed to the prospective buyer so that the latter is then in an economically better position to evaluate the worth of his purchase. This is the only feature that distinguishes the **Murābaḥah** contract from other kinds of sales.

2. The **Murābaḥah** contract is not independent of other associated rules and/or conditions formulated by the classical Islamic jurists of the diverse Islamic legal schools.

3. The profit added to the actual cost of an article is left to the discretion of the seller and no ceiling rate is specified as a maximum since this is left to economic factors of supply, demand, production and acquisition costs etc. This should not violate Islam's emphasis on fairness and thus, no client, must be sold commodities at unfair prices and exploitative rates.

   Islamic banks face the competition from conventional interest banks and, thus, do not necessarily seek to have their profit margins exceed interest rates of conventional banks.

   The profit in a **Murābaḥah** can be determined by mutual consent, either as a fixed amount or by an agreed percentage above the cost price of the article to be sold.

   Islamic Banks generally charge a stable profit rate to all clients to be fair towards all.

   Since the selling price in a **Murābaḥah** contract must be fixed at the instance of the contract, it leaves clients who contracted to pay over extended periods or terms at a

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[1] In cases where a seller did not purchase an asset but acquired it through inheritance, a gift or any other legitimate means, the contract is concluded under **Musāwamah. Musāwamah** is not much different to the **Murābaḥah** contract except in the sense that the seller/bank is not required to disclose the cost price of the commodity sold.

In this case, the client should attempt to negotiate a rate that he finds most profitable. **Musāwamah** can be used in cases where the financing institute perhaps buys a significant quantity of vehicles at a special discount and then re-sells the same at normal prices (+ mark up) without being obligated to disclose its cost. The State bank of Pakistan now also contracts on the basis of **Musāwamah**.

disadvantage if they subsequently have or gain the capacity to pay the full amount due long before maturity e.g. if a person buys a house valued at $100 000 and would repay over ten years. Then a profit mark-up calculated at an annual rate of 10% to possibly cover inflation over the period would imply that the client is due to pay $200 000 for the house right from the inception of the contract. However, if the client manages to pay back in one year, Islamic banks do not refund him for the additional 9 years of profit calculated in their profit margin. In this sense, the interest based financial model is fair towards its clients. The so-called Islamic model is definitely unfair since, after a year, if the client has repaid, the value of the house would under normal economic circumstances most likely be valued at a price that is far less then the $200 000 that the client has paid.

In terms of taxation, the Islamic Banking calculation of the mark-up does create an immediate liability upon the client, and in this sense, may have greater taxational benefits from the first financial year since a larger liability is already in the financial statements. In contrast, the interest model allows for a reduced liability since the interest is only a monthly or annual addition.

4. Any date agreed or credit term mutually agreed upon by the parties that would solidify the creditor's claim on the date of maturity is allowable. There is no limit to the date of repayment. However, for economic reasons, Islamic banks are compelled to fix a monthly instalment and a fixed term of repayment.

5. A commodity sold on the basis of **Murābaḥah** can only be sold on such basis if the seller had purchased it on cash. Alternatively, the seller has to disclose the fact that the asset on offer was purchased on credit (and has not yet been fully paid).[2]

   This requirement ensures that the seller cannot demand maximum profits through falsely claiming to have outlaid the full capital requirements.

   Very often people profit through using the capital resources of others. Where this becomes visible in a **Murābaḥah** contract, the seller could be pressured by a client to accept a lower profit margin since the seller has not paid for the total amount of the asset sold. The seller's investment is thus at an economically lower status then an investment that was fully paid for.

6. It is essential that the seller disclose the length of time that the commodity for sale had remained in his stock.

   I have not located a basis for this condition in the prophetic traditions. Therefore, it is most likely, a preferential condition added by the jurists in order to be most sincere towards the client.

   We can very vividly see the benefit of placing such a condition on the seller:

   e.g. if a person selling computers conceals to a client that the system he purchases has very little memory that cannot be upgraded and that even the latest operating system would fail to install on it, or that the programs required for this outdated system would be located with great difficulty that does not justify the economic resources spent on it, then any of us would declare that the seller has deceived the ignorant client, and that the ignorance of the client did not justify the seller's exploitation in order to get rid of an obsolete item.

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[2] Mabsūṭ - Ḥanafī jurisprudence. This view is also held by ʾImām Mālik (refer to Mudawwanah).

By this clause, we note that the **Murābaḥah** contract was meant to be executed with great consideration of the buyer's needs, and that the seller was to almost act as a purchaser on behalf of the buyer.

This imposition of this clause also indicatively allows us to add further clauses to this contract in relation to changing circumstances and products provided that these are done in fairness to all the parties and with the proviso that other associated Islamic rules are not infringed.

7. Where an agent sells an item on behalf of another on the basis of **Murābaḥah**, the agent is obligated to sell the item on a cost plus basis in terms of his supplier's cost.

## 4. The contract considered by Islamic Banks to be a Murābaḥah contract or the Banking format of Murābaḥah.

Since Islam prohibits the taking of interest, capital owners realized that the forwarding of non-interest bearing loans would lead to a loss of the future purchase values of the loans they extended to borrowers due to inflation and other factors.

As, an alternative strategy to exact profit on their provision of loans, instead of providing a loan on which no interest could be levied, they opted to directly or indirectly purchase the assets/commodities sought by the person seeking finance. They did this only if they were certain that they could re-sell the same at a profit to the person seeking a loan. In this contrived way, they neither directly exacted interest (Riba) and also fulfilled the economic need of the "would be borrower" with the exception that the latter now has an additional cost above the previously expected or fixed cost of the asset required.

Islamic banks and financing institutions are essentially doing nothing more different than the above.

Therefore, the first critical difference between the classical definition of **Murābaḥah** in Islamic jurisprudence and its application in Islamic banks is that the banks are not the primary owners of the asset/commodity required by the client. Banks thus act as traders by purchasing the required asset from the person from whom the client intends to buy in order to sell the same to the client at a profit. It does not provide a loan since Islam prohibits charging interest on a loan. It thus profits indirectly to reach the same objective of interest.

Classical Islamic law has not sanctioned the **Murābaḥah** contract, as a tool and technique to gain profit that is to be employed by those providing capital as applied by Islamic banks. The only way that it becomes a financing technique is if a client buys an asset on credit directly from the owner/or primary seller but on the basis of **Murābaḥah**.

Despite the differences between the original Islamic juridical meaning of a Murābaḥah contract and the application by Islamic Financial institutions, it is still not exactly equivalent to a loan forwarded in expectation for a fixed Ribā (interest) amount or a compounded Ribā return because the contract does apparently entail the requirements for a valid sale and also because the amount owed by a client who purchases on credit cannot be increased as in the case of a pure interest-based loan which is increased in a ratio related to the subsequent time extension granted for whatever reasons. Simultaneously, these characteristics do not eliminate the fact that the customer who could have bought a car for $20 000 dollars if he had the cash, is now compelled to pay an additional amount, the pricing of which is purely dependent upon the extension of time that the client seeks for repayment. In fact, like the interest mechanism,

Islamic banks factor return on the sale of the asset by adding a profit rate that is equivalent or almost equal to current interest rates of interest exacting banks. The longer the period of repayment, the higher are the profits charged by Islamic banks in the same way reflected by yield curves in the term structures of interest calculations.[3]

It should be clearly noted that early Muslim jurists have not, in traditional literature, dealt with the implications of a fractional reserve monetary system since, the latter, by its nature was a later innovation. Such a monetary system entails a theoretical emulation of diverse natures of underlying assets as well as reflected monetary values in relation to economic variables. Such a system allows a capitalist market to economically rape the hard earned sweat of nations.

Pricing mechanisms in Islamic banks, in Muslim and non-Muslim states, therefore have no escape from calculating cost in terms of market related interest returns.

Most of the Islamic banks and financial institutions as well as Islamic Windows in non-Islamic banks classify "**Murābaḥah**" as an Islamic mode of financing asset requirements of clients. However, their application of **Murābaḥah** differs from the original and classical format of a **Murābaḥah** contract.

Thus, Retired Justice Mufti Taqi Ustmani and many other renowned scholars have very unjustifiably defined **Murābaḥah** in terms of the contemporary Islamic banking application instead of its actual classical format and interpretation. Their failure to clearly distinguish the two diverse formats is unpardonable.

The essence of the contemporary Islamic banking format of **Murābaḥah** can be understood by non-Muslims in the following terms: When God prohibits you to fish on Saturday, you trap the fish on Saturday and remove them from the water on Sunday. – What is the difference then in the violation of God's law.

Most of the financing operations of Islamic banks are based on the banking format of " **Murābaḥah**" purely because it has the least risks and allows for mitigating the risks on their capital outlay and expected profits. Risks are reduced through demanding collaterals, accepting sureties as well as via tapping into the insurance systems which may or may not be Islamic.

Contemporary banking and financial formats of " **Murābaḥah**" do not find validity in most schools of Islamic Law. There are four main divisions of Islamic jurisprudence with the Salafi school following as a much later development. In terms of some classical Ḥanafī and Mālikī jurists, this contract is impermissible since it ultimately allows the financing party to accrue the same profit as he would have achieved through directly extending the loan and charging an interest.

Some contemporary Islamic jurists have allowed such contracts on a temporary basis purely because it is a lesser form of evil in relation to the direct forms of exacting interest in situations where a fully Islamic contract of sale cannot be concluded on credit.

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[3] Financial Managemenet. 5th Edition. Carlos Correia, David Flynn, Enrico Uliana and Michael Wormald. 2003, Juta & Co. Ltd 2003, Lansdowne, South Africa, ISBN 0 7021 6033 4.

Few contemporary Ḥanafī jurists who accepted the application of the Murabahah contract as applied by Islamic Banks despite its impermissibility according to them have done so on the basis of contemporary need (Darūrah) amidst Muslim society.

The principle of need (Darūrah) is one of many principles /theories in Islamic jurisprudence which allows for the relaxation of specific rulings in specific circumstances. The implications for a Muslim customer, in such a case, is that he does not make use of such a contract except if he has a need that demands him to purchase the asset on such a basis. Thus, purchasing a luxury vehicle that is not an economic requirement would not be within the purview of allowance given to him

Those who claim that Imam Shafi allowed this contract have incorrectly used his statement which sanctions any contract that is apparently valid even though the motives, objectives thereof are incorrect for as long as such objectives are not manifest. There is no denial that the entire Murabahah contract as applied by Islamic banks is nothing but an indirect avenue to exact an interest on a loan since the client that approaches the bank does so on the basis of getting finance and not because the bank is the primary seller of the commodity sought by the client.

The only manner in which an Islamic financial institution can truly claim to apply the Murabahah contract is if it directly purchases homes, cars and other commodities, and then offers the same for sale.

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Due to the reality that the contemporary banking format of Murabahah does not strictly comply with all the juridical regulations pertaining to the actual Murabahah contract it is rather safest to regard Murabahah as a figurative term for a generic class of very similar and inter-related Islamic trade contracts. However this would place a strain on the categorization of the profits for the purpose of gaining sanction as Islamically permissible (Halaal) in regard to the investors who are conscious of earning non-interest bearing profits since the acceptance of their worship is totally dependent upon Halaal income. I thus deem it justified that Islamic banks segregate the pure Murabahah contracts from the contracts that are presently executed as Murabahah.

A Murābaḥah contract may be concluded on cash or on credit. However, in both cases, the seller (bank) and the purchaser must agree on the price. The credit term can be negotiated.

**5. The practical dimension to the Islamic Banking format of the Murabahah contract**

a. A Customer who is unable to finance an asset requires finance for the same and thus approaches the bank.

b. Since the Islamic Bank cannot lend the customer money in return for exacting an interest, the bank offers to buy the required asset from the seller in order to gain ownership which is an Islamic pre-requisite for it to subsequently sell the same to the customer.

c. Cost of purchasing the asset from the bank is calculated [entailing the cost of the goods + % percentage mark up by the bank]. Other legal costs and administration costs are then also added to calculate the ultimate cost.

The % percentage mark up by the bank varies in relation to the period of repayment and is also determined by Islamic banks in non-Muslim and Muslim countries via currently interest rates of conventional banks.

d. As normal, any upfront payments towards financing the asset sought by the client are deducted, and a mark-up is only placed on the amount financed.

e.g. in car sales, the trade in value of any car traded in as part of the sale is deducted from the purchase price of the car that is purchased.[4]

e. If the customer accepts the ultimate and calculated or pre-determined cost of purchasing the asset from the bank, the bank purchases the asset from the seller and, sometimes, profits through receiving a cash discount. Where such discounts are received, the same cannot be sold on a Murabahah basis if the discount is concealed.

However, prior to purchasing the asset, the bank also takes a legally binding contract from the customer that the customer will subsequent to the bank's purchase, purchase the same from the bank at the specified amount. The bank will not buy the object unless the (potential) buyer's promise to purchase is binding.

The asset is either directly purchased by the bank or, generally, the client is asked to act as an agent on behalf of the bank. An agency agreement is concluded, in which the customer is also authorized to take delivery of the goods.[5] However, the supplier of the goods should invoice the goods in the name of the Bank and not the agent. This requirement has been waived by some banks in order to cater for local tax requirements.[6]

f. Risks in the Goods from the date of delivery by the supplier to the Bank until the date and time of re-sale of the same to the customer by the bank shall be borne by the bank.

g. Transfer of ownership is only passed to the client after full payment of the purchase price. In the interim prior to that, that bank retains constructive possession.

h. Insurance. Clients are obliged to insure the assets financed at their own cost even though ownership may not have been legally transferred to them.

The insurance contract, in non-Islamic and Muslim states, is generally an un-Islamic in nature. Emergent Islamic insurance companies demand that Islamic banks obligate clients to insure the vehicle or asset through Islamically acceptable modes of insurance.

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[4] In this case the bank's client is considered to have engaged in to a partnership with the bank in the purchase of required vehicle. The bank provides their share via liquid capital and the client pays for his share via providing a trade-in vehicle of specified value. The client then buys the bank's share of the vehicle.

Alternatively, the bank buys the client's present vehicle and later credits the client with the amount received for it. Generally this is only done if there is an upfront agreement that the seller from whom the bank buys the asset/vehicle which is required by the client, acknowledges to accept the vehicle of the bank's client at a specific price. This latter format has been applied by Al-Baraka Bank South Africa 2007.

[5] Al-Barakah (South Africa operates this way), 2007.

[6] Al-Barakah (South Africa operates this way), 2007.

i. Banks generally have standard legal contracts that leave little space for the customers to negotiate specific terms. It is essential that some alternatives be developed so that, beyond the domain of the financial implications, the contract is concluded in a spirit of support and brotherhood.

j. Penalty clause for default in paying the instalments

(1) obligating the client to contribute to charity. (Al-Baraka South Africa specifies a charge of 0,07 per day on the overdue amounts. This is equivalent to 2,1 % monthly and 25,2 % annual. This charge is only levied if the default is not due to financially stringent circumstances)

(2) further administration charge

k. The bank would also do its normal credit checking and client rating prior to the approval of the deal. Although this was not done in the early era of Islam, it is an essential component for the protection of the capital of the shareholders and depositors. Levels of dishonesty and fraud in contemporary society demand that clients be financially scrutinized.

l. Indemnity clauses which do not violate the spirit of fairness and which are appropriate to the nature of the asset sold can be included in the contract. Such clauses should neither infringe any Islamic provisions.

**6. The legally binding nature of a successful application for a Murābaḥah contract prior to the actual conclusion of the contract.**

The client who requests the bank, to purchase the specified asset and then sell it to him after adding a percentage of profit may subsequently fail to honour this agreement for a number of justified or unjustified factors. This would then imply that the financing body may acquires an asset that cannot be easily sold or that would have to be sold at a loss in order to re-gain its cash outlay and profit through other avenues

In order to mitigate this risk, the financial institutes have sought to find Islamic justification to legally bind the applicant via what is known as a “binding promise to purchase the specified asset which he/she wants the bank to sell to him at a specified price”.

## 7. Mathematical determination of the sale/purchase price

1. Since a Murabahah contract must be mutually acceptable, the bank is not obliged to fix the rates of profit. Profit rates are generally pegged to ensure fairness across all clients.

2. Depending on the capital outlay, the bank may purchase also purchase the required asset on interest-free credit and thus lower its charges on the client.

3. I have not checked the pricing mechanisms of this contract with Islamic Banks. They could be using any one of the following two calculation examples

1. (a) cost of actual goods + (b) % percentage of bank mark up in relation to period of return so that the return almost equals interest returns over the same period since the interest rate is assumed as a fair indicator of inflation + (c) costs of actual transportation/shipping etc or legal and administration costs.

(5000 + 30 %) + 300 = 6500 + 300 = 6800

2. (a + c) total cost of goods (actual costs of goods + costs of transportation/shipping etc. ) + (b) % (percentage of bank mark up in relation to period of return so that the return almost equals interest returns over the same period since the interest rate is assumed as a fair indicator of inflation) +

(5000 + 300) + 30 % = 5300 + 1590 = 6890

Example one would be the fairer format of calculating the rate of profit since the mark up is on the actual cost of the goods.

In example two, the mark up includes a 30% profit on an abstract and non-tangible transportation or shipping of the commodity. It is possible that a seller includes these and other costs associated to the actual costs of the goods in order to determine the total cost of the goods.

Where the seller expresses to sell the goods at actual cost of the goods + a mark up + associated expenses, then example one must be used. Where the seller expresses to sell the goods at total cost of the goods + a mark up, then example two must be used.

4. Person (A) has sold to (C) on the basis of Murabahah. Where person (A) then subsequently receives a discount from the person (B) from whom he/she had acquired the asset, the equivalent thereof shall be deducted from the person (C) unto whom (A) has sold.

ʾImām Ash-Shāfiʿī does not consider (A) to be obligated to pass such a discount over to person (C). In the spirit of fairness and in consideration for the client, it would be an act of graciousness for Financial Institutions to adopt the view of ʾImām ʾAbū Ḥanīfah R.A. in this regard.

5. Very often, an Islamic Bank would rather model the financial implications of the Murabahah contract under existing lease or hire-purchase agreements where the last residual payment entitles the lease holder to gain ownership.

In fact, a lease agreement with a residual amount that entitles the client to gain ownership would be fully Islamic and a better Islamic choice for a client than engaging in the existing format of the Murabahah transaction as applied by Islamic Banks.

Also, the fact that classical jurists of specific Islamic legal schools have not sanctioned the contemporary Islamic banking format of Murabahah, such a contract should not be utilized for non-essentialities and luxuries. This also then jeopardizes the legitimacy of the earnings of depositors and shareholders whose capital is used to fund such contracts.

**8. Some Islamic Legal exemptions on the contemporary Murabahah contract**

1. Transfer of ownership

In pure Sharīʿah (Islamic Legal) terms, once a commodity or asset is sold, the purchaser gains ownership thereof immaterial of the fact that he may be indebted to the seller for the same.

This implies that the owner has the right and privilege of selling the same to a third party. However, due to fraud and other cases of abuse, Shariah Scholars have allowed the legal transfer of ownership to only pass to the purchaser after the financed asset is fully paid for.

**9. Some areas where the Islamic banking format of the Murābaḥah contract is applied in Islamic Banks**

1. Housing and other fixed business or industrial property
2. Motor vehicles
3. Office equipment
4. Machinery
5. Tangible assets.
6. Consumables (in relation to wholesalers and suppliers)

**10. Contemporary and other Scholars who sanctioned the format of Murabahah contracts as applied by Islamic Banks.**

The following Muslim scholars are claimed to be in full support of the Murābaḥah scheme, which is used as a viable alternative to Ribā (interest) dealings:

1) Sh. Muhammad Sulyman Al-Ashqer
2) Sh. Badr Mutwalli Abdul-Basset
3) Sh. Mustafa Alzarqa
4) Sh. Muhammad Mahmoud Alsawwaf
5) Sh. Mufti Mahmoud (Pakistan)
6) Sh. Alsayed Gholam Ali (Islamic University - Pakistan)
7) Sh. Mufti Sayed Sayuddeen Kakakhil (Islamabad)
8) Sh. Muhammad Khater Muhammad
9) Sh. Abdullah Ibrahim Al-Anssari
10) Sh. Dr. Muhammad Alsiddiq Alddareer
11) Sh. Zakaria Elberri
12) Sh. Yusuf Al-Qaradawi
13) Sh. Ali Abdul-Qadir
14) Sh. Abdul-Sattar Abu-Ghudda
15) Justice Mufti Muhammad Taqi Usmani[7]
16) Shaikh Abdul-Aziz Ben Baz of Saudi Arabia

**11. Other features of a Murābaḥah contract.**

1. It is not permissible to increase the sale price stated on the signed agreement of sale due to late payment by the customer.

2. The bank/financer reserves the right to provide the client a discount in the event of an earlier payment.

3. The bank could demand for a collateral and/or surety/sureties on a Murābahah contract.

**12. Consideration of country-specific legal requirements pertaining to the Murābaḥah contract.**

[7] See Addendum One.

The format in which Islamic financial instruments are structured is influenced by the local financial and legal regulatory frameworks of diverse countries. Thus, a single bank with a multitude of subsidiaries in diverse countries could end up with a few different contracts on the financing format and its associated legal contracts purely because the base contract has to be modified to find acceptance within the economy of implementation.

## 13. Non-Muslims and Islamic banks

Islam does not prohibit non-Muslims from investing in Islamic banks or from concluding contracts with Islamic financial institutions on the basis acceptable to Islamic law.

Likewise, Muslims are not juridically prohibited from contracting with non-Muslim private or juristic persons on the basis allowed by Islam.

**Note by Ahmed Fazel**

I have abridged the above from an extensive paper that I have compiled on the subject.

Subhaanallah
Alhamdulillah
Allahu Akbar

May Allah fully reward all those who have enabled me to have the time to write this paper and have facilitated my journey to deliver and distribute it.

I now release this paper,
on this night of Ramadhan,
for the pleasure of Allah