

Purification of Non-Halal Income in Malaysian Islamic Banks: An Overview

Penyucian Pendapatan Tidak-Halal Di Bank-Bank Islam Malaysia: Satu Tinjauan

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Abstract

Purification of non-*halal* income (NHI) is the process of deducting non-*halal* or tainted income deemed unacceptable by *Shari'ah* from the total income generated in Islamic banks. It is undeniable that *Shari'ah* non-compliance events still occur in Islamic banking system considering the fact that Islamic banks have not been able to fully comply with the requirements of *Shari'ah* in their transactions, operations and financial activities. The realization of *Shari'ah* non-compliance events in Islamic banks in some situations involve a financial impact which leads to NHI. All NHI identified must be purified since Islam does not allow any non-*halal* income to be held, kept and utilized for their own benefits. This paper will give a new insight on purification of NHI by first delineating the concept of *māl ḥarām* in Islam as well as the *Shari'ah* non-compliant events realized in the banks, with special reference to cases involving Islamic banks in Malaysia.

Keywords: Islamic banking, non-halal income, purification, charity, *waqf*.

Abstrak

Penyucian pendapatan tidak halal (NHI) adalah proses memisahkan pendapatan tidak halal menurut Syari'ah daripada jumlah keseluruhan pendapatan yang dihasilkan oleh bank Islam. Tidak dapat dinafikan bahawa masih berlaku ketidakpatuhan Syariaah dalam sistem perbankan Islam. Ini adalah kerana bank Islam tidak dapat

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mematuhi sepenuhnya keperluan Syariah dalam transaksi, operasi dan kegiatan kewangan mereka. Kewujudan perkara yang tidak mematuhi Syariah di bank Islam dapat memberi kesan kepada status kewangan yang boleh membawa kepada berlakunya pendapatan haram. Pendapatan tidak halal yang sudah dikenalpasti mesti disucikan kerana Islam tidak membenarkan apa-apa pendapatan tidak halal disimpan dan digunakan untuk faedah mereka sendiri. Kajian ini memberi pandangan baru tentang penyucian pendapatan tidak halal dengan membincangkan konsep harta haram dalam Islam serta perkara-perkara yang tidak patuh syariah yang berlaku di bank-bank Islam di Malaysia.

Kata Kunci: Perbankan Islam, pendapatan tidak-halal, Penyucian, Amal, wakaf.

Introduction

Unlawful incomes seeps into Islamic banks in several ways, such as via internal factors like human and system error, improper process and external factors like dealings with foreign conventional banks¹. The testimonies to this reality are reports from both local and international banks. For instance, reports made by *Shari'ah* Supervisory Council or Board of various banking institutions prove the existence of NHI in Islamic banks. *Shari'ah* Supervisory Council of Bank Islam Malaysia Berhad (BIMB) has reported that their NHI realized throughout the financial year of 2012 amounted to RM2,570.65. This figure shows a reduction from the amount in 2011, which was RM40,941.67². Similarly, Bank Muamalat Malaysia Berhad (BMMB) recognises that the bank had earned NHI from prohibited means, which has since been disposed to charitable causes.³ It is reported that the amount was RM392, 175 as of 31 March 2012.⁴ At the international level, although the figure of NHI generated in al-Baraka Banking Group was not stated in their annual report, it was announced that, in the financial year ending 31 December 2012, the portion of NHI obtained was disposed of to charity for purification.⁵

If that is the situation, then anything that opposes *Shari'ah* rules can be deemed as invalid and can lead to impermissible returns, earnings and profits which, in Islamic law, cannot be considered valid income for the banks. Ibn Taymiyah regards that dealing with unlawful money is

¹ BIMB, *BIMB Annual Report* (Kuala Lumpur: Bank Islam Malaysia Berhad, 2012).

² BIMB, *BIMB Annual Report* (Kuala Lumpur: Bank Islam Malaysia Berhad, 2012).

³ BMMB, *BMMB Annual Report* (Kuala Lumpur: Bank Muamalat Malaysia Berhad, 2012), accessed December 15, 2016 <http://www.muamalat.com.my>

⁴ Ibid.

⁵ Al-Baraka. *Al-Barakah Annual Report* (Bahrain: Al-Barakah Banking Group, 2011), 74.

prohibited because it is an unjust (*ẓālim*) act to the real owner as the money is obtained without the lawful right recognized by *Sharī'ah*.⁶ Reiterating this, al-Baz asserts that NHI cannot be possessed and benefitted by Muslims for there are unlawful elements associated to the property which need to be purified. To jurists, therefore, these kind of incomes needs to be treated through *Sharī'ah* approved mechanisms which this paper is going to discuss.⁷

Juristic Exposition of Unlawful Income and its Purging Procedures

Muslim jurists pointed out the avenues through which unlawful income can intermix with one's lawful earning and they proposed procedures to purify such income. To start with, unlawful income in banking jargon is called non-halal income (*māl ḥarām*). *Māl ḥarām* is an income that is obtained through unlawful means according to the *Sharī'ah* which could not be benefitted and owned by Muslims. Al-Zuhayli says *māl ḥarām* is the wealth which the *Sharī'ah* prohibits its consumption and acquisition due to the harm that it brings to the consumers (*ḥarām lidhātihi*). It involves unlawful means of acquisition which violate people's rights even though it is agreed by the parties.⁸ This basically is related to *ḥarām lighayrihi*. Al-Ashqar maintains that *māl ḥarām* is a property which cannot be used or benefitted by the holder whether the prohibition is made in the *Quran*, a prophetic text (*hadith*), consensus (*ijma'*) or decisive evidence (*adillah al-mu'tabarah*).⁹ However al-Baz adds that the *māl ḥarām* could not be owned and benefitted.¹⁰

As to what comes within the scope of *māl ḥarām*, some classical Muslim jurists detailed them based on their definition of it as the property that was obtained through unlawful means. This could be seen from

⁶ Ibn Taymiyah. Taqī al-Dīn Abū al-'Abbās ibn 'Abd al-Salām, *Majmū'ah al-fatāwā li Shaikh al-Islām Taqiy al-dīn Ahmad Ibn Taymiyah*, ed. Al-Jundī & Al-Sharqāwī (al-Qāhirah: Dār al-Ḥadīth, 2006), 117-118.

⁷ Al-Bāz, 'Abbās Ahmad bin Muḥammad, *Aḥkām al-māl al-ḥarām wa dawābiḥ al-intifā' wa al-taṣarruf bihi fī al-fiqh al-Islāmī* (Urdūn: Dār al-Nafāis, 1999).

⁸ Al-Zuhaylī, Wahbah, *Fatāwā mu'āṣirah* (Dimashq: Dār al-Fikr, 2003), 559.

⁹ Al-Ashqār, 'Umar Muḥammad Sulaymān, "Aḥkām al-māl al-ḥarām wa ḥukm ikhrāj zakātihi," in *Abḥath fiqhiyah fī qaḍāyā al-zakāt al-mu'āṣirah*, ed. Al-Ashqār, Yāsīn & Shibīr (1st edn., pp. 79-99). (Urdūn: Dār al-Nafāis, 1997), 81

¹⁰ Al-Bāz, 'Abbās Ahmad bin Muḥammad, *aḥkām al-māl al-ḥarām wa dawābiḥ al-intifā' wa al-taṣarruf bihi fī al-fiqh al-Islāmī* (1st edn.), (Urdūn: Dār al-Nafāis, 1999), 40.

their discussion on unlawful means like usury (*riba*), uncertainties (*gharar*), gambling (*maysir*), fraudulence, robbery, hoarding, bribery, stealing and conducting *Shari'ah* non-compliant business like selling pork, alcohol, dead animals and dealing in prostitution and pornographic activities.¹¹ Some contemporary Muslim scholars expanded the area to comprise current unlawful income obtained from lottery, dealing with conventional banks and investing in *Shari'ah* non-compliant businesses that involve interest (*riba*) based financial services, gambling and betting operations, selling and purchasing of unlawful assets, conventional insurance, prohibited entertainment, selling of tobacco or related products which are harmful, dealing in unlawful securities and all unacceptable activities that violate the precept of *Shari'ah*.¹²

As to how to deal with this problem, classical Muslim jurists proposed their own juristic methods when discussing impure money or properties that were obtained through means not acceptable by *Shari'ah* such as stealing, robbery with violence (*hirābah*) and usurpation (*ghasb*). Their discussion generally concentrated on individuals' responsibility of purifying the unlawful money or property rather than the responsibility on the part of organizations, institutions, companies, corporations and entities.¹³ However, those classical discussions have shed light to the need of purification of unlawful income by all Islamic banks in Malaysia.

Contemporary Muslim scholars have discussed purification of unlawful income from modern sources. According to them one has to purify such income in order to avoid the sins of keeping the unlawful money and preventing them from utilising it. Al-Zarqa says that revenue from lottery, trading of pork, alcohol and other prohibited materials should be

¹¹ Al-Ghazzālī, Muḥammad bin Muḥammad, *Ihya' 'ulūm al-dīn* (Bayrūt, Dār al-Ma'rifah, n.d); Al-Salami, Muḥammad Mukhtar, "Zakāt Māl Ḥarām," in *Abhāth wa a'māl al-nadwah al-thānīyah li qaḍāyā al-zakāt al-mu'āṣirah* (pp. 111–127) (Kuwayt: Al-amānah al'ammah al-hai'ah al-Shar'iyyah al-'alamiyyah li al-zakāt: Bayt al-zakāt, 1989); Ismā'īl, Ḥāmid Maḥmūd, "Zakāt Māl Ḥarām," in *Abhās wa a'māl al-nadwah al-thānīyah li qaḍāyā al-zakāt al-mu'āṣirah* (pp. 129–159) (Kuwayt: Al-amānah al'ammah al-hai'ah al-Shar'iyyah al-'ālamiyyah li al-zakāt: Bayt al-zakāt, 1989).

¹² Al-Qaraḍāwī, Yūsuf, *The Lawful and the Prohibited in Islam* (1st edn.) (London: Al-Birr Foundation, 2003); El-Gamal, Muḥammad Amin, *Islamic Finance: Law, Economic and Practice* (New York: Cambridge University Press, 2006).

¹³ Al-Mardawī, *Al-inṣāf fi ma'rifat al-rājih min al-khilāf 'alā madhhab al-Imām Aḥmad ibn Ḥanbal* (1st edn.), (Bayrūt: Manshūrat Muḥammad 'Alī Baydūn, 1997); Al-Bahūtī, Maṣṣūr ibn Yūnus, *Kashāf al-qinā' 'an matn al-iqnā'* (Bayrūt: Dār al-Kutub al-'Ilmiyyah, 1997); Ibn Rushd, Abū al-Walīd Muḥammad ibn Aḥmad, *Bidāyah al-mujtahid wa nihāyah al-muqtaṣid* (Bayrūt: Dār al-Kutub al-'Ilmiyyah, 2004).

accumulated in a specific account, to set apart from permissible revenues. It should be handed over to the poor and needy or channeled to charity for the benefits of Muslims.¹⁴ Meanwhile, al-Zuhayli opined that the only method to free oneself from engaging in unlawful property is by channeling the property to the poor or giving charity for the benefits of Muslims.¹⁵

According to both traditional and contemporary Muslim jurists, all unlawful properties, profits and money must be purified and could not be kept, utilized and consumed for personal benefit. They are required to be disposed of as to avoid the possessor from committing a sin. In general, money gained through illegal means should be returned to the real owner. In case the real owner has died, the heirs have the right to own the said property or money. If the heirs are unknown, the property has to be given to charity especially to the needy and poor. In situations where the real owner is unknown, the property is required to be channeled to charity for public interest.¹⁶

Al-Ghazzali in his discussion on the purification of unlawful money asserts that the impure money or property obtained, for example, through stealing should be returned to the real owner. This is in the case if the real owner is still alive and known. In the event that the real owner has passed away, the property or money is required to be returned to the heirs and if the heirs are unknown, the unlawful income holder has to wait for their presence. While waiting for the heirs, any kind of increment or profit made from the stolen property should be kept and accumulated for the heirs. If they still do not claim it, then the property should be disposed of to charity. He further explains that, if a property is obtained illegally and does not belong to a specific person but rather it belongs to Muslims in general such as booties or spoils obtained through actual fighting (*ghanimah*) or without fighting (*al-fay'*) i.e the enemies surrenders or flees away, the property should be channeled for the Muslims'

¹⁴ Al-Zarqā, Muṣṭafā, *Fatāwā Muṣṭafā al-Zarqā'* (Dimashq: Dār al-Qalam, 2004).

¹⁵ Al-Zuhaylī, Wahbah, *Fatāwā mu'āṣirah* (Dimashq: Dār al-Fikr, 2005), 80-102.

¹⁶ Al-Ḥaq, Jād al-Ḥaq 'Alī Jād, *Buḥūth wa fatāwā Islāmiyyah fī qaḍāyā mu'āṣirah* (al-Qāhirah: Dār al-Ḥadīth, 2005); Ghanāyim, Muḥammad Nabīl, *Qaḍāyā mu'āṣirah dirāsah fiḥiyyah ijtmā'iyah* (Al-Qāhirah: Dār al-Hidāyah, 2003), 146-147

benefits like building roads due to the difficulty in identifying the huge number of the recipients.¹⁷

Similar to al-Ghazzali, Ibn Taymiyah outlined Imam Ahmad's and Abu Hanifah's opinions which state that the impure property must be donated to the poor and needy when it is hard to find the real owner. This is said to be the consensus among the four schools of thought in Islamic jurisprudence.¹⁸

In relation to the donation as discussed by Ibn Taymiyah, al-Mawardi says that donation should be given first to immediate relatives. It is also deemed desirable or considered recommendable to donate to non-Muslim as long as they are poor, orphaned or prisoner of war.¹⁹ This is based on the Quranic injunction (*Qur'ān*, 76: 8).²⁰ Ibn Taymiyah also discusses profits accumulated from impure activities, for instance profit generated from trading prohibited goods and selling stolen property with the permission of the real owner. In this context, he surmises as to whether or not such profit can be owned and utilized, and whether or not it has to undergo purification or not seems to be a contentious issue. Ibn Taymiyah was of the view that such a profit could be owned on condition that the principal amount is first returned to the owner.²¹ His other contemporaries held that it should be treated as a case of partnership between them and the Muslims. Therefore, they obtained half of the profits and the other half was given to the state treasury.

Al-Mawardi says that unlawful property or money could be disposed to charitable bodies like Islamic government's state treasury (*bayt al-mal*) if the owner is unknown. This is based on his discussion on found property (*luqatah*) when there is no claim after a complete lunar year (*ḥaul*) of its announcement.²² In a similar vein, Ibn Rusd asserts that, the majority of Muslim jurists agree on the idea that a found property (*luqatah*) with no claim made after a stipulated time can be consumed

¹⁷ Al-Ghazzālī, Muḥammad bin Muḥammad, *Ihya' 'ulūm al-dīn* (Bayrūt, Dār al-Ma'rifah, n.d).

¹⁸ Ibn Taymiyah, Taqī al-Dīn Abū al-'Abbās ibn 'Abd al-Salām, *al-Halāl wa al-ḥarām wa ba'du qawā'idihimā fī al-muāmalāt al-māliyah* (Bayrūt: Maktabah al-maṭbū'āt al-Islāmiyah, 1995).

¹⁹ Al-Māwardī, Abū al-Ḥasan 'Alī ibn Muḥammad ibn Ḥabīb, *al-ḥāwī al-kabīr* (Bayrūt: Dār al-Fikr, 1994).

²⁰ *Surah al-Insan*: 8. Allah (SWT) says, "And they give food in spite of love for it to the needy, the orphan and the captive."

²¹ Ibn Taymiyyah, Taqī al-Dīn Abū al-'Abbās ibn 'Abd al-Salām, *Majmū'ah al-fatāwā* (2nd edn.) (Riyāḍ: Maktabah al-Abikan, 1998).

²² Al-Māwardī, *al-Ḥāwī al-kabīr*.

by the poor and needy but not the rich people. If it happens to be in the hand of a rich man, it requires disposal to charity. As such, in purifying unlawful income in Islamic banking, it is much better if it is given to the poor rather than the rich. Similar to al-Mawardi's opinion, Ibn Rushd mentions, money with unknown owner should be given to Islamic government's state treasury (*bayt al-māl*).²³

Al-Bahuti discusses received property (*al-maqbudh*) via invalid or void contract. He opines that the property received is invalid. According to him, the treatment of the unlawful property is to return it to the real owner although a contract has been made with the permission of the contracting parties. This is because the property is still in the ownership of the real owner. Contemporary Muslim scholars have also discussed purification of unlawful income or money and its treatments. According to them, one has to purify such income in order to avoid the sins of keeping the unlawful money and preventing them from utilising it.²⁴ In line with this, al-Zarqa says that revenue from lottery, trading of pork, alcohol and other prohibited materials should be accumulated in a specific account, to set apart from permissible revenues, and then it should be handed over to the poor and needy or channeled to charity for the benefits of Muslims.²⁵

Wahbi Sulayman al-Albani opposes the opinion of al-Zarqa regarding the permissibility of dealing with interest-based bank. According to him, the depositor should immediately withdraw the money from the bank and repent to Allah (SWT). The interests obtained from the deposited money should be taken out for the sake of the poor and needy, not to leave it for the benefit of the banks as the poor is more deserving. The depositor is not entitled to the interest because it is unlawful thus, does not have the right for personal consumption.²⁶

Meanwhile, al-Zuhayli opines that the absolute method to free oneself from engaging in unlawful property is by channeling the property to the poor or giving charity for the benefits of Muslims. However, according to him, no reward could be expected from such action and the charity channeled should not be used for building mosques. The use of unlawful property for building mosques and performing pilgrimage how-

²³ Ibn Rushd, Abū al-Walīd Muḥammad ibn Aḥmad, *Bidāyah al-mujtahid wa nihāyah al-muqtaṣid* (Bayrūt: Dār al-Kutub al-ʿIlmiyah, 2004).

²⁴ Al-Bahūtī, Maṣṣūr ibn Yūnus, *Kashāf al-qināʿ ʿan matn al-iqnāʿ* (Bayrūt: Dār al-Kutub al-ʿIlmiyah, 1997), 3: 253-257.

²⁵ Al-Zarqā, Muṣṭafā, *Fatāwā Muṣṭafā al-Zarqāʿ*.

²⁶ Ibid.

ever is a disputed matter among Muslim scholars.²⁷ In addition, al-Zarqa says that all interests paid by conventional banks are unlawful but the depositor must take them and hand them over to the poor and needy. This has been practiced by social organizations especially Islamic banks to purify their income. However, the step by step procedure is not well explained to the customers by Islamic banks.²⁸

Another Muslim scholar, Jad al-Haq 'Ali Jad al-Haq discusses the purification of profits generated from interest-based transactions. The profits should be purified by channeling it to the poor or charity with the intention to build mosques, hospitals, roads and schools for the benefit of Muslims. He adds that, leaving the interest with the bank is forbidden for fear that the profit may be utilised by the banks in activities that do not comply with Islamic rules and regulations, which could harm the superiority and the dignity of the religion as well. According to him, the majority of Muslim jurists are of the opinion that unlawful properties could not be utilised and thus should be given to the original owner if he is known and alive. However, if he has passed away, then the property is for his heirs. If the heirs are absent, waiting for their presence and giving them all the profits accrued from the property is most required. In a situation where the unlawful property is not owned by a person, rather it is owned by many people, the process of identifying them could lead to difficulty. As such it should be channeled for Muslims' benefits.²⁹

According to Ghanayim, illegal property possessed by an individual requires purification by returning it to the real owner or giving compensation in case the property is damaged. The first step of doing the purification is immediate repentance to Allah SWT (*tawbah nasuha*) with determination of not repeating such act in the future. He adds that regarding income which is mixed with interest-based transactions, the identified portion of unlawful money or property should be purified through donation to suitable authorities for the benefit of all Muslims.³⁰ However a question arises on how to identify and deduct the portion of unlawful income or money from the *halal* if the amount is not exactly

²⁷ Al-Zuhaylī, Wahbah, *Al-fiqh al-Islāmī wa adillatuh* (Bayrūt: Dār al-Fikr, 2005), 80-102.

²⁸ Al-Zarqā, Muṣṭafā, *Fatāwā Muṣṭafā al-Zarqā*, 123-124

²⁹ Al-Ḥaq, Jād al-Ḥaq 'Alī Jād, *Buḥūth wa fatāwā Islāmiyyah fī qaḍāyā mu'āṣirah* (Qāhirah: Dār al-Ḥadīth, 2005).

³⁰ Ghanāyīm, Muḥammad Nabīl, *Qaḍāyā mu'āṣirah dirāsah fiqhiyyah ijtmā'iyyah* (Qāhirah: Dār al-Hidāyah, 2003), 146-147.

known? This issue seems not to have been deliberated by scholars until now.

Unlawful income and its gateways in Islamic banks

In the context of Islamic banking, unlawful income could be realized from five main sources, i.e., *Shari'ah* non-compliant products, unlawful deposits from depositors, defective documents, *Shari'ah* non-compliant business operations and interest received from conventional banks. Islamic banking products will generate unlawful income when they involve the following: invalidity of contract³¹, unfulfilled specific contract conditions³² and insertion of *Shari'ah* non-compliant conditions³³ in a contract.

In the case of deposits where sources are unlawful, it is impermissible for banks to receive and utilise them to generate income. In this case, it is unlawful and sinful for any Islamic bank to receive the deposit as it could assist in many ways to expand the depositors' benefits and support their unlawful activities.³⁴ As for deposits from both lawful and unlawful activities, the main issue in question is whether or not Islamic banks are allowed to receive the deposits from such depositors.

Apart from *Shari'ah* non-compliant products and unlawful deposits from depositors, defects in documentation can also contribute to unlawful income. Documentation is a process of preparing documents that describes a contractual relationship between contracting parties who are involved in a transaction and outline the rights and responsibilities that

³¹ Invalidity of contract refers to the existence of Shariah non-compliant elements in the structure of products which normally occur through combination of contracts. Combination of contracts refers to the agreement between parties to put together two or more contracts with different features and legal consequences to become a new transaction or contract.

³² This pertains to the pillars of contract that support the product and more particularly, relates to the status of the subject matter in terms of its permissibility, availability and deliverability, the conditions of the statement of contract (*sighah*) and the contracting parties (*al-'aqidān*)

³³ This refers to the insertion of conditions that are against the nature or concept of products. It means that extra conditions which are not part of the contract are inserted in a product for the contracting parties' security that go against the concept of the product and the rules and regulations of *Shari'ah*.

³⁴ Ibn Taymiyah, Taqī al-Dīn Abū al-'Abbās ibn 'Abd al-Salām, *Al-ḥalāl wa al-ḥarām wa ba'du qawā'idihimā fī al-muāmalāt al-māliyah* (Bayrūt: Maktabah al-maṭbū'āt al-Islāmiyah, 1995).

must be carried out by those parties.³⁵ This is pertinent particularly in developing a new product. According to *Guidelines on Introduction of New Products* as issued by BNM, all documents used to support the development of new products should be validated by the *Shari'ah* Committee of the respective banks for *Shari'ah*-compliance. The documents include product proposals, offer letters, agreements, any other legal documentation, product manuals, marketing advertisements, brochures and sales illustrations that are used by Islamic banks in describing and promoting their products to the public.³⁶

Any issue relating to the documentation process found in the product's literature has the possibility to cause defects in the process. Issues like early disbursement of financing amount which relates to letter of offer³⁷, terminologies and clauses used, descriptions of products, terms and conditions stipulated in the documents are required to be well perceived to minimize the possibility of later nullification of the product.³⁸

Similarly, unlawful income in Islamic banking could be generated from *Shari'ah* non-compliant business operations. It is therefore, necessary to ensure that the operations of Islamic banks do not involve these prohibited elements and are carried out properly according to *Shari'ah* principles, as stated in Islamic Banking Act 1983. It is also of paramount importance to ensure that the operation is in accordance with the objectives and philosophies or the concepts prescribed by Islamic banks to avoid *Shari'ah* non-compliance which may affect the profits. With this end in view, a body called *Shari'ah* Advisory Council (SAC) of BNM has been established under section 51 of the Central Bank of Malaysia Act 2009, to issue rulings on financial matters and advise banks on *Shari'ah* issues relating to Islamic banking operations.³⁹

³⁵ Saiful Azhar Rosly, "Shariah Parameters Reconsidered," *International Journal of Islamic and Middle Eastern Finance and Management* 3, no. 2 (2010): 132–146.

³⁶ BNM, *Guidelines of Introduction of New Product* (Kuala Lumpur: Bank Negara Malaysia, 2011), accessed from <http://www.bnm.gov.my>.

³⁷ Letter of Offer here refers to a letter issued by the bank to offer the financing facility to the customer. It is one of the instruments used by the bank in its banking operations.

³⁸ IBFIM, *Workshop on Legal Documentation for Islamic Consumer Banking* (Kuala Lumpur: Islamic Banking and Finance Institute Malaysia Sdn Bhd., 2006); Zulkifli Hasan, "A Shariah Perspective on the "Letter of Offer" as Practiced by the Islamic Financial Institutions: A Comparative Study with the Malaysian Law of Contract", *Malaysian Journal of Shari'ah and Law* 1, no. 1 (2004): 56-69.

³⁹ BNM, *Shariah Governance Framework for Islamic Finance Institutions* (Kuala Lumpur: Bank Negara Malaysia, 2010), accessed from <http://www.bnm.gov.my>.

Some events in Islamic banking operations which yield unlawful earnings can be enumerated as follows:

1-Bay' inah⁴⁰

In the implementation of *bay inah* by an Islamic bank, an asset will be sold by an Islamic bank to a customer (buyer) at a certain price on deferred payment. Then, the buyer will sell the asset back to the Islamic bank on cash basis at another price. According to Securities Commission:⁴¹

“*Bay inah* refers to trading whereby the seller sells his assets to the buyer at an agreed selling price to be paid by the buyer at a later date. After that, the buyer immediately sells back the assets to the seller at a cash price, lower than the agreed selling price. The majority of Islamic jurists state that there are three forms of trading categorised as *bay inah*, whereby it can be concluded that all the assets sold come from the financier. The financier will sell a product to the buyer at an agreed price to be paid later. The financier then immediately buys back the asset at a cash price lower than the deferred selling price.”

Although *bay inah* is permissible and being practiced in Malaysia, however, its practice sometimes involve non-*Shari'ah* compliant element that need to be corrected. It was found in one of Malaysian Islamic banks that the asset concluded by one party in one contract is at the same time in lease by another party. According to Islamic transaction law, any leased asset should not be used by the lessor or lessee for any other transactions. The lessee cannot use the leased asset for any purpose other than that stated in the lease agreement and the use of the leased asset must be *Shari'ah* compliant. Similarly, the lessor (in this case refers to the Islamic bank) is also not allowed to use the leased asset for another transactions. The Islamic bank has realized this mistake and in this case the

⁴⁰ The Shariah Supervisory Council Of Bank Negara Malaysia (BNM) in its 8th meeting held on 12th December 1998/ 23 Syaaban 1419 resolved that bai` inah transaction is permissible based the following conditions:

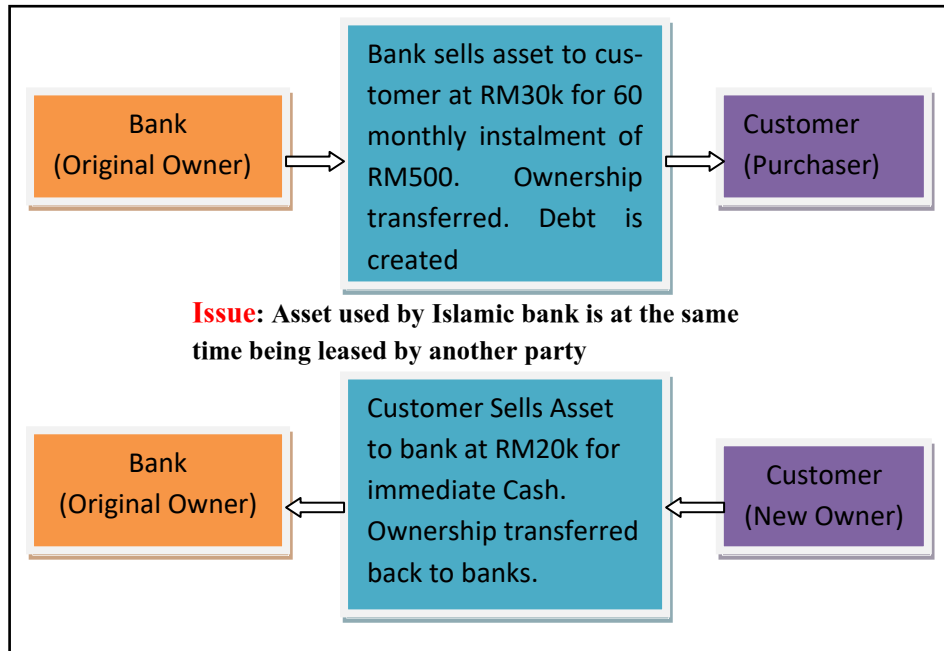
(i) *Bay inah* transaction must follow the mechanism which is accepted by Syafii school and

(ii) The transacted good is not a *ribawi* item.

⁴¹ Securities Commission. (2007). *Resolutions of the Securities Commission Shariah Advisory Council* (Kuala Lumpur: Securities Commission, 2007).

transaction is terminated. The profit obtained was not considered as income and it was given back to the bank's client.

Figure 1: Modus operandi of *bay inah*



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According to Islamic law, this is a void contract because the subject matter's condition is not fulfilled. This is because the status of the subject matter is in lease. According to juristic perspectives, a contract could be valid if the subject matter conditions are fulfilled. Among the conditions is ability to deliver to the buyer. According to Shirbīni (n.d), the ability to deliver the subject matter legally and physically could determine the status of a contract in Islamic transaction. In one of the cases of *bay inah* transaction practiced by one Islamic bank, the subject matter could not be delivered legally and physically because it is at the same time being used for lease (*ijarah*). Such situation makes the contract (*bay inah*) practiced by the Islamic bank uncertain (*bay' gharar*).

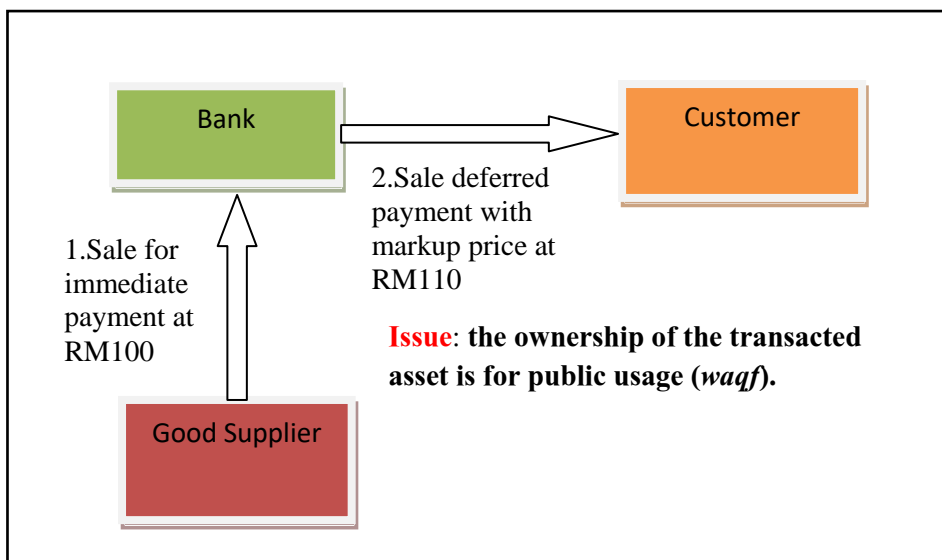
As to how the banks deal with this kind of situation, in one instance, the bank revoked *bay inah* and returned the profit to the client. In this case the bank decided to return the profit to the client because the transaction is void (*batil*). Even though the transaction was concluded

and has reached a mutual agreement by both parties, the money still needed to be returned to the customer or the real owner as they did not know the mistake of the contract and they had no bad intention entering into the contract. There was no element of coercion or cheating the customer in order to gain profit.

2-Murabahah to purchase orderer (MPO)

In *murabahah* transaction, a bank (seller) will sell an asset to the customer (purchaser) after the asset first bought by the seller from the supplier. The asset is sold for cost plus profit, and both the purchaser and seller know the cost and the profit involved. Basically, this product is a kind of trade financing instrument used by Islamic banks. This contract is called *murabahah* to purchase orderer (MPO) and it is done after promise to buy the specified asset from the seller upon the seller's acquisition of the asset from the supplier has been made by the purchaser. This contract has been widely practiced by Islamic banks as one of their financing methods currently. However, for the contract to be valid in practice, some conditions should be observed especially those related to its components; contracting parties, asset and the price.

Figure 2: The mechanism of murabahah



Created by the author

It is found that an Islamic bank has mistakenly practiced this contract because the conditions of the asset are not well observed. The Islamic bank did not really investigate the ownership of the commodity sold by the supplier. In this case, the underlying asset was the item which was designed for public usage and this resulted in difficulties in transferring the ownership of the asset. The ownership in the *murabahah* asset must be effectively transferred from the seller to the purchaser upon entering into a valid sale and purchase contract.⁴²

Again, being a void (*bātil*) contract, the ownership of *murabahah* asset could not be transferred to the purchaser since it is not owned by the seller as well as supplier but belongs to *waqf* for public usage. Thus the seller is not entitled of any right to sell to the purchaser. According to the Islamic principles any kind of selling and buying transaction involving transferring of ownership, the seller should first legally own the asset. According to Islam any asset under *waqf* purpose cannot be sold since it is violating the principles of *waqf* sanctioned by Islam.

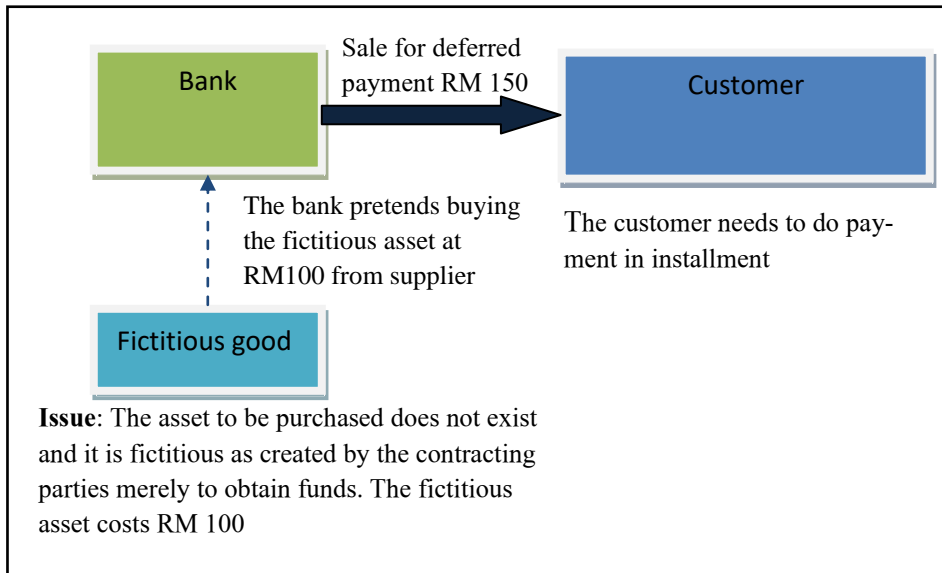
This problem was also handled by the Islamic bank through nullification of the transaction and the profit obtained is returned to the purchaser although the contract was concluded by mutual agreement between the purchaser and the seller. This is because the customer did not know that the ownership of the underlying asset does not belong to the bank.

3-Murabahah

Unlawful income in Islamic bank also found through *murabahah* transaction implemented by one of Islamic banks where the asset that are to be purchased in *murabahah* are not in existence. This is in the case where the seller (Islamic bank) and the purchaser (customer) concluded their transaction merely to obtain funds and not to possess goods. To satisfy the *murabahah* requirements, the seller and purchaser merely creates fictitious commodity. This violates the nature of *murabahah* which is to finance the commodity the customer intended to purchase. The transaction is prohibited because it resembles loan that contains *riba*. The figure below illustrates the procurement of unlawful income in a transaction concluded by the Islamic bank and a customer in *murabahah* transaction.

⁴² Saiful Azhar Rosly, *Critical Issues on Islamic Banking and Financial Markets (Islamic Economics, Banking and Finance, Investments, Takaful and Financial Planning)* (Indiana: Author House, 2005).

Figure 3: Procurement of unlawful income in *murabahah* transaction



Source: Created by the author

In Islamic law, the above case provides another avenue for unlawful earning. The reason is that in Islamic law, one of conditions for sale and purchase contract to be valid is the existence of a subject matter (goods being sold). The conditions of the subject matter must be existent and even though it is not available during the selling and buying session, it must be deliverable. According to Muslim jurists, the non-existence of the subject matter (*ma'dum*) would make the transaction void for the reason of uncertainty (*gharar*). The transaction is invalid. However, if the non-existence element is not associated with uncertainty (*gharar*) the contract still can be valid.⁴³ The Islamic bank admitted the mistake and revoked it immediately. Hence, the bank held that it has to be channeled to charity and not returned to the real owner because the transaction is concluded by mutual consent with intention.

4-BBA based on bay inah contract

Bay' bithaman ajil (BBA) as defined by Bank Negara Malaysia (BNM) is a deferred payment sale whereby property requested by the cli-

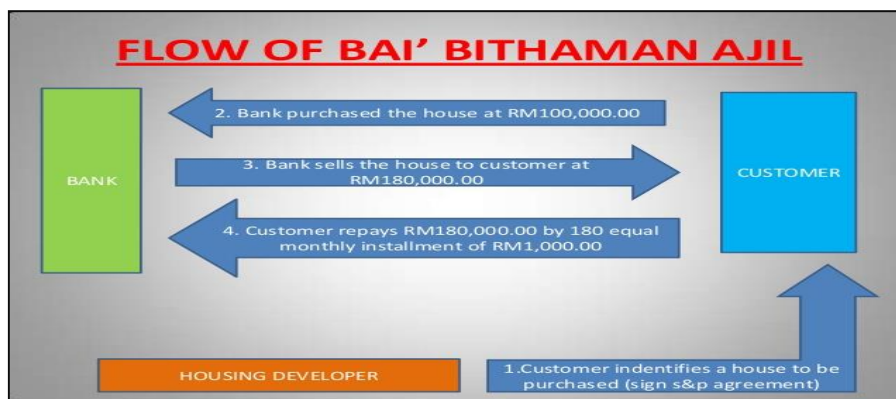
⁴³ Ibn Qayyim, Muhammad ibn Abu Bakr al-Zar'i, *I'lām al-Mūqi'in 'an Rabb al-'Ālamīn*, ed. Ṭāhā 'Ābd al-Ra'ūf Sa'd (Bayrūt: Dār al-Jayl, 1973).

ent is bought by the financier, who subsequently sells the goods to the client at an agreed price, including a mark-up (profit) for the Islamic bank. The selling price is fixed and agreed by both parties and will remain unchanged until the end of the payment period. The ownership of the property purchased will be under the claim of the financier and will be handed over to the customer upon full payment.⁴⁴

The application of BBA financing in Islamic banks involves certain agreements; Property Purchase Agreement (PPA) and Property Sale Agreement (PSA). PPA is executed by Islamic banks who will buy the property from purchaser at the purchase price. However, PSA will be undertaken and guaranteed by the customer to repurchase the financed property from the Islamic bank at certain selling price agreed by both parties.

Stipulation to repurchase a commodity purchased is found incorporated in BBA based on *bay inah* contract. It is found that the Islamic bank has imposed stipulation to repurchase which indicates the purchaser's responsibility to purchase the asset back from the seller i.e Islamic bank. The stipulation is observed in both Property Sale Agreement (PSA) and Property Purchase Agreement (PPA).

Figure 4: The transaction flow of BBA financing in Islamic banks



Source: Adapted from <http://www.slideshare.net/>

In Islamic jurisprudence, imposing a stipulation on purchaser (customer) to buy back the asset after selling it to the bank is prohibited in Islam. This is because it is against the nature or the concept of selling contract as prescribed by Islam and this lead to the procurement of non-

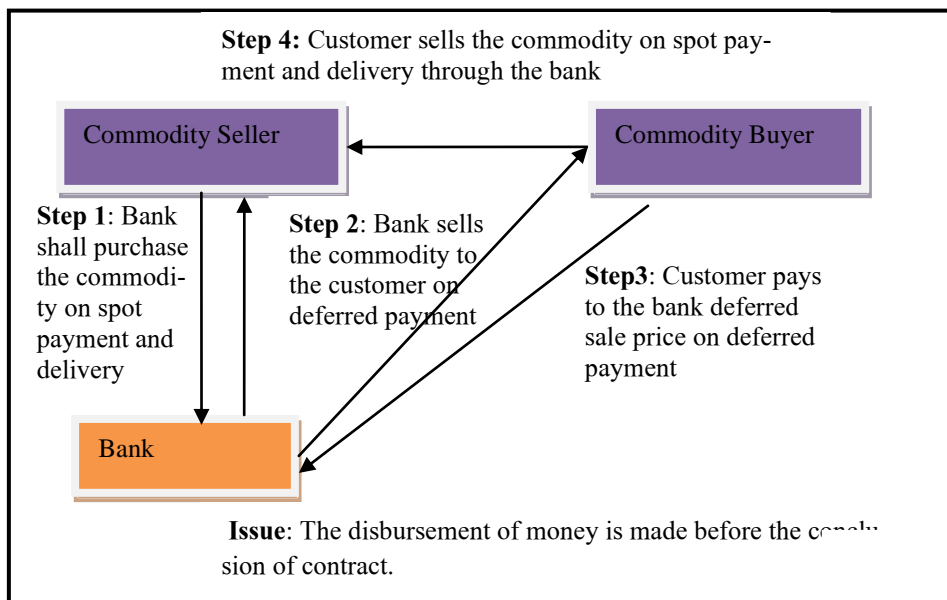
⁴⁴ BNM, *Shariah Resolutions in Islamic Finance* (2nd ed.) (Kuala Lumpur: Bank Negara Malaysia, 2010).

halal income. The stipulation of guarantee in *bay' bithaman ajil* (BBA) to ensure that customers will buy back the property after the property has been purchased by the bank is considered unlawful.⁴⁵ Thus, the unlawful income is realized here by the Islamic banks and it is channeled to charity.

5- Commodity Murabahah or Tawarruq

In this transaction, a customer initiated commodity *murabahah* by notifying one of the Islamic banks. Then the bank purchased the commodity and delivered it to the customer on spot with mark-up price. The customer then sold the commodity to a commodity buyer on spot and the delivery was through the bank. And then the customer paid deferred sale price on deferred payment to the bank.

Figure 5: The transaction flow of commodity *murabahah* financing



Source: Created by the author

⁴⁵ Saiful Azhar Rosly. (2005). *Critical Issues on Islamic Banking and Financial Markets (Islamic Economics, Banking and Finance, Investments, Takaful and Financial Planning)*. Indiana: Author House.

In this case, the disbursement of money was made before the conclusion of contracts. It means that the customer received the financing amount from the potential buyer of the commodity (the bank) just after the customer initiated and signed the commodity *murabahah* contract with the bank i.e before the sale agreement is concluded, which is impermissible. This is because the contract resembles loan which contains element of *riba* merely to facilitate cash. Accordingly, the bank channeled it to charity as the money gained through illegal means should be returned to the real owner and if the real owner has died, the heirs have the right to own the said property or money. If the heirs are unknown, the property has to be given to charity especially to the needy and poor. In situations where the real owner is unknown, the property is required to be channeled to charity for public interest.

Analysis and recommendations

It is observed that Islamic banks in Malaysia are trying to purify the unlawful income realized in the institutions through channeling it to charity. However there are certain cases where the unlawful income is returned back to the original owner (customers). This is in the situation where the unlawful income is procured through the transactions that do not reach mutual agreement of the contracting parties and the parties concluded the transactions without prior knowledge that it is invalid.

It is understood that the Islamic banks channel the unlawful income to charity if the void transaction is concluded with the permission of the contracting parties. However, if it is concluded without the permission of the contracting parties the unlawful income is returned to the original owner but they do not mention whether the end recipients are poor and needy people or public treasury. This is very important to make sure that the channel is correct according to *Shariah* perspectives. From the cases, the unlawful income in the banks yielded due to the *Shariah* non-compliant event method that mistakenly occurred.

In the first case where the subject matter transacted is at the same time in lease is not allowed to be engaged in another transaction by the bank. The bank held that the profit obtained from the second transaction using the same item is non-*halal* and it was returned back to the real owner, not to charity. This is in line with what has been mentioned by the Muslim jurists. According to them, although the income yields through a transaction by mutual consent, but if knowledge about the legality of the subject matter is unknown, the income should be returned to the owner since it is still in the owner's ownership.

In the second case, the profit was obtained through a void transaction whereby the asset being transacted does not belong to the seller. The bank held that the profit gained is to be returned to the real owner who in this case is the purchaser. This is in line with the Muslim jurists' opinion who said that any profit procured without the knowledge about the legality of a subject matter is still in the ownership of the real owner. Thus, need to be returned.

In the third case, the profit was channeled to charity because the transaction concluded is void. This is due to the subject matter or the asset is not existent and merely created to facilitate the transaction. According to Muslim jurists the profit must be channeled to charity because the void transaction was known by the contracting parties before the transaction was made.

In the fourth case, the bank channeled the profit obtained through a transaction where a stipulation to buy back the asset is imposed on the purchaser. This is prohibited in Islam and the bank held that the profit to be channeled to charity. This is in accordance with the Muslim jurists' whose opinion is to give to charity if the void transaction is concluded by mutual consent whereby the void transaction is known and agreed to be concluded by the contracting parties.

In the fifth case the profit is given to charity because the money was paid prior to the conclusion of the contract. The agreement of selling and purchase was not yet signed and it is prohibited in Islam. According to Muslim jurists it is prohibited in Islam and the profit must be channeled to charity because the void transaction is known before the conclusion of the contract.

As for recommendation, this study needs to be expanded since it is vital to provide a method of purifying impermissible income for Islamic banks. The purification process must closely adhere to the *Sharī'ah* for it to be valid. For example, in giving a donation to its recipients, the donor is not allowed to have any personal benefit, be it material or non-material. A step by step process in purification must be provided for the Islamic banks to facilitate them in carrying out the process since different Islamic banks adopt different ways in purifying NHI. Even though charity is the method currently practiced by Islamic banks, having further study in this field is crucial to make the process clear and transparent so that it does not oppose any injunctions of the *Sharī'ah*.

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