

PROHIBITED ELEMENTS IN ISLAMIC FINANCIAL TRANSACTIONS: A COMPREHENSIVE REVIEW

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Abstract

This paper analyzes prohibited elements in transactions from a shari'ah perspective, since it is obligatory on the individual (fardhu 'ayn) to understand the Islamic law of transactions (fiqh mu'amalat). Islam is not only a religion, but also a complete way of life. Islam has clearly forbidden all business transactions that lead to exploitation and injustice in any form to any of the parties of a contract. Islam requires that all financial and business transactions be based on transparency, accuracy, and disclosure of all material information so that no one party takes advantage of other parties. There is wisdom (hikmah) behind every prohibited transaction and in order to practice business and banking activities that are genuinely shari'ah-compliant, it is important to understand the prohibited elements in Islamic law. Accordingly, prohibited elements such as riba, gharar, qimar, maysir, fraud and coercion are discussed, as well as, the importance of the legality of the subject matter. Sahih, fasid, batil contracts and extrinsic conditions are covered in respect to different schools of thought.

Keywords: *fiqh mu'amalat, riba, gharar, maysir, khilabah, ikrah, mahal al-aqd, sahih, fasid, batil, Islamic finance*

1. Introduction

Islam has clearly forbidden all business transactions that lead to exploitation and injustice in any form of any party of a contract. Islam requires that all financial and business transactions be based on transparency, accuracy, and disclosure of all material information so that no one party takes advantages of another party.

Instead, the *shari'ah* promotes the principle of profit-loss sharing between banks and entrepreneurs as an approach to encourage the spirit of brotherhood and cooperation in business relationships. Mutual risk-sharing could help absorb the weight of loss by sharing it equitably between all parties. However, risk and uncertainty are conditioned by adequacy and accuracy of information to make reasonable estimates of the outcomes. Meanwhile, in order to earn legitimate income, that is, from an Islamic perspective, the financial transactions should be free from several prohibited elements which are shown in Table 1.

Table 1: The Main Prohibited Elements in Financial Transactions from an Islamic Law Perspective

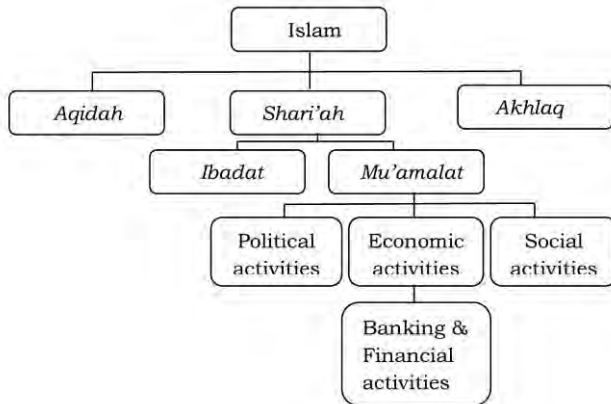
| The Main Prohibited Elements in Financial Transactions | |
|---|--|
| Free from <i>riba</i> (an increase without <i>'iwad</i> or equal counter-value) | Free from <i>khilabah</i> (fraud), <i>ghishsh</i> (deception) and <i>al-ikrah</i> (coercion) |
| In compliance with the <i>maqasid</i> of <i>shari'ah</i> | Entitlement to profit depends on liability of risk |
| The subject matter must be <i>halal</i> | Contracts based on free mutual consent |
| Devoid of <i>gharar</i> (uncertainty, indeterminacy) | “What is not explicitly prohibited is permissible” |
| Free from <i>qimar</i> (gambling) and <i>maysir</i> (games of chance) | Extrinsic conditions |

Therefore, this paper examines various prohibited elements in financial transactions from an Islamic perspective. First of all, the literal and technical meaning for each prohibited element is discussed followed by the evidences for prohibition are investigated based on *Qur'anic* verses and *hadiths*. Finally, some important conclusions are made and implications drawn with respect to modern Islamic banking and finance.

2. *Mu'amalat*

Islam is not only a *din* (religion), it is a way of life, which comprises sets of *Shari'ah* rules relating to *ibadat* (devotional acts), *mu'amalat* (transactions), *munakahat* (marriage) and *jinayat* (criminal). Any activity of a Muslim is guided and governs by these *shari'ah* rules in order to achieve the five objectives of *shari'ah* or *maqasid al-shari'ah*. The *maqasid al-shari'ah* are the protection of the *din* (religion), the protection of the *nafs* (life), the protection of the *nasl* (progeny), the protection of the *'aql* (intellect) and the protection of the *mal* (property).

Figure 1: The Relationship between the *Shari'ah* and Islamic Economics and Finance



Source: Ismail (1992, p. 250)

This paper shall focus on matters that relate to *mu'amalat*, which refers to financial or economic transactions. The relationship between the *shari'ah* and Islamic economics and finance is shown in Figure 1. *Mu'amalat* are matters pertaining to individuals interacting amongst themselves. The variety of this interaction is neither foreseeable nor capable of being complied with a regime of fixed rules. They are also changeable in different epochs of time within various geographical entities. In view of this, *shari'ah* has laid down rules in connection with *mu'amalat* within a general framework so

that different people at different places and at different times may seek guidance². Observation and compliance of these rules are crucial in achieving the *maqasid al-shari'ah*.

3. *Sahih*, *Fasid* and *Batil* Contracts

The Muslim scholars classify contracts into *sahih* (valid), *batil* (void) and *fasid* (voidable or irregular) contracts according to their legal validity. The details of these contracts are illustrated in Table 2.

Table 2: The Classification of Islamic Contracts According to their Legal Validity

| Contract | Descriptions |
|-----------------------|---|
| <i>Sahih</i> Contract | <p>A <i>sahih</i> contract is that whose <i>asl</i> (nature and essence) and <i>wasf</i> (accessory circumstances or attributes) are in tune with Islamic law. Therefore, a valid contract enjoys the following features¹:</p> <ol style="list-style-type: none"> 1. Its elements are complete; 2. Conditions relating to elements are met; and 3. It is free from external prohibited elements. <p>There is no disagreement among the Hanafi jurists and other jurists regarding this meaning of the <i>sahih</i> contract.</p> <p>There are two categories of a <i>sahih</i> contract, i.e., the <i>nafidh</i> (operative and immediate enforceable contract) and <i>mawquf</i> (suspended contract).</p> <p><i>In a nafidh</i> contract (a) the elements are fully satisfied; (b) the conditions are met; (c) the external attributes are legal; and, (d) the contract is not dependent upon ratification.</p> <p>In a <i>mawquf</i> contract, the first three conditions are the same as the <i>nafidh</i> contract. However, in this contract, the effects are dependent upon ratification.</p> <p>The former contract is accepted by all schools, whilst the latter contract, is accepted by only the Hanafi, Maliki and some Hanbali jurists. Shafi'i and some Hanafi jurists do not accept the delay in the effects of the contracts².</p> |

¹ M. Tahir Mansuri, *Islamic Law of Contracts and Business Transactions*, (New Delhi: Adam Publishers & Distributors, 2010), 4.

² *Ibid.*, 81-84.

| Contract | Descriptions |
|-----------------------|--|
| <i>Fasid</i> Contract | <p>In a <i>fasid</i> (irregular) contract, elements are present and all the essential conditions are complete; however, an external attribute included in this contract is forbidden by the lawgiver. The contract is legal in respect to its origin (<i>asl</i>), but it is irregular due to the prohibition of the attribute (<i>wasf</i>)³.</p> <p>Some crucial elements that cause a contract to be <i>fasid</i> are as follows⁴:</p> <p><i>Riba</i> or undue enrichment; Want of knowledge leading to dispute; Defective consent, for example, by coercion; and invalid condition or an ancillary condition not a collateral to the contract and not admitted by commercial usage and is one, which gives advantage to one of the contracting parties at the cost of the other. The details will be explained in the following sections.</p> |
| <i>Batil</i> Contract | <p>A <i>batil</i> contract is against Islamic Law in respect to both its essence and external attributes. It does not give rise to any effect. Thus, no ownership is transferred nor is any type of obligation created.</p> <p>In this contract, there is also no room for ratification. If a <i>batil</i> contract is executed by a person suffering from a terminal illness, then the creditors or heirs still have a right to claim restitution of property.</p> <p>There are two types of general causes, which would result in invalidating a contract, namely intrinsic causes and extrinsic causes.</p> <p>Intrinsic causes involve the unlawfulness of subject matter (<i>mahal</i>), absence of contractual capacity, non-existence of the subject matter and illegal purpose⁵.</p> <p>Extrinsic causes are related to external attributes such as that the contract includes element of <i>riba</i> or <i>gharar</i>.</p> |

4. The Subject Matter Must be *Halal*

The subject matter of contract (*mahal al-aqd*) must be permissible (*halal*) in the *shari'ah*. That means the substance must be pure and ritually clean. Therefore, any substance, which is religiously and legally unclean and upon whose disposal there are restrictions, cannot serve as an object of sale: e.g. wine, pig, intoxicants, blood, and the

³ Ibid.

⁴ Ibid.

⁵ Ibid., 88-89.