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JURISTIC METHODS OF PURIFYING *HARAM* INCOMES: AN ANALYSIS IN THE CONTEXT OF ISLAMIC BANKS IN MALAYSIA¹

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Abstract

This study attempts to articulate juristic mechanisms by which Islamic banks in Malaysia can purge the unlawful income from their assets. An Islamic bank being a modern corporate entity when dealing with people of diverse cultures and conventional business entities, at times, feels the pressure of not being able to stay away from transactions tainted with haram. Islamic banks as a matter of principle should not involve themselves in any unlawful business activities in the process of which they can procure unlawful incomes. A question of how Islamic banks in Malaysia should treat such incomes, both classical and contemporary jurists have proposed their own set of juristic methods. This study recommends the Islamic banks to address the importance of undertaking the purification process of haram income according to Shari'ah.

Keywords: *haram* income, Purification, Islamic banks, riba-based transactions

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Introduction

It is argued by many that Islamic banking is another gateway for a capitalist banking system as, in practice, it receives *haram* (unlawful) incomes in the same way as conventional banks. It accumulates earning through backdoors when it deals with conventional financial markets by receiving foreign currencies. In facilitating such transactions, Islamic banks have to open a nostro account² in a foreign bank to keep their reserves of foreign currencies with fixed interest rates.³ Moreover, some of its products are claimed to have been developed based on disputable and controversial contracts from an Islamic vantage point.⁴ In addition, the transformation of banks from conventional to an Islamic financial entity is hard to come by without secretion of unlawful incomes into its overall revenue. Accordingly, if that is the scenario, any such unlawful income generated by the banks cannot be owned by it based on the Islamic principle of ownership.⁵ Now, the option for the bank is to rid itself of such an earnings, which are termed as purification of *haram* income in the Malaysian context. To this end, it has developed its own mechanisms which this study enumerates for the purpose of evaluating their compliance with the *Shari`ah*.

A Framework

Distinguishing features of an Islamic bank, which demarcate it from a conventional bank, is to be free of *riba*, uncertainty (*gharar*), gambling, and other unlawful trading.⁶ *Riba* literally means growth

² Nostro account refers to an account at a foreign bank where a domestic bank keeps reserves of a foreign currency. A bank keeps a nostro account so that it does not have to make a currency conversion (which brings with it foreign exchange risk) should an account holder make a deposit or a withdrawal in that foreign currency. Refer to <http://financial-dictionary.thefreedictionary.com/Nostro+account>.

³ Mahmoud El-Gamal, "Involving Islamic Banks in Central Bank Open Market Operations, *The International Journal of Accounting*, 41, no. 4/5 (1999): 514.

⁴ Siti Khadijah Ab Manan and Norlela Kamaluddin, "The Underlying Contracts of Islamic Banking (IB) Products and Some Related Issues in the Current Practice", Special Issue, *Malaysian Accounting Review* 9, no. 2 (2010): 99.

⁵ Abdul Aziz, Abdullah ibn al-Baz, *Ahkam al-Mal al-Haram wa Dawabit al-Intifa' wa al-Tasarruf bihi fi al-Fiqh al-Islami* (Urdun: Dar Al-Nafais, 1999), 23.

⁶ Saad Abdul Sattar al-Harran, "Time for Long-Term Islamic Financing", in

in something or an addition to the amount of the principal.⁷ In a banking context, *riba* can be defined as an addition in the principal of loan in which the addition is based on the time value whereby no intervention has been made by the financier to cause the growth.⁸ It is unjust and exploitative as the capitalists accumulate wealth without expending any effort. Operationally, *riba* applies to any benefit obtained from giving a loan or extension of the loan payment, known as interest in the modern economy.⁹ In classical *fiqh*, *riba* has two sub-varieties, *riba al-fadl* and *riba al-nasi'ah*. The former involves bartering goods of different counter values while the latter partakes on increment on loans. Islamic law unequivocally prohibits all forms of *riba*.

Nevertheless, some scholars contend that present-day interest cannot be equated with the pre-Islamic practice of *riba*. Furthermore, *riba* is unavoidable in the modern banking system as the economy will not be successful without practicing it. Some even has gone to the extent of differentiating between simple and compounding *riba*, permitting the former and prohibiting the latter.¹⁰ However, the issue was put to rest by the decision of the Federal *Shari'ah* Court of Pakistan which held that *riba* covers both usury and interest regardless of its amount whether excessive or minimal. Likewise, the contention that the practice of *riba* is unavoidable in this current banking system is frivolous as all Allah's (ﷻ) commandments are within the capacity of human beings, thus *riba* is an avoidable practice.¹¹

Leading Issues in Islamic Banking and Finance, ed. Saad Abdul Sattar al-Harran (Petaling Jaya: Pelanduk Publication (M) Sdn. Bhd, 1995), 25.

⁷ Ibn Quddamah, *Al-Mughni*, ed. Khitab, Sayyid and Şadiq (Al-Qahirah: Dar al-Hadith, 2004), 385.

⁸ Brian Kettel, *Case Studies in Islamic Banking and Finance*, (United Kingdom: Wiley, 2011).

⁹ Kamal Khir et al., *Islamic Banking: A Practical Perspective*, (Petaling Jaya: Pearson Malaysia Sdn. Bhd., 2008).

¹⁰ Imran Ahsan Nyazee, *The Prohibition of Riba Elaborated Nyazee*, (Lahore, Pakistan: The Federal Law House, 2009).

¹¹ Ismail Hamid Mahmud, "Zakat Mal Haram", in *Abbas wa A'mal al-Nadwah al-Thaniah li Qadaya al-Zakat al-Muasarah*, (Kuwait: Al-Amanah al-Ammah al-Hai'ah al-Shariyah al-Alamiyah lil Zakat, 1989), 135.

Gharar implies hazard, risk and uncertainty.¹² According to the Hanafi jurists, *gharar* implies something that has consequences which are uncertain or concealed.¹³ Maliki jurists stated that *gharar* could occur in two situations which relate to the existence of the subject matter and its quantity or weight.¹⁴ Shafi'e jurists view *gharar* as a bargain whereby the subject matter is concealed in which its future result is unknown.¹⁵ Hanbali jurists, however, view *gharar* as the uncertainty of a subject matter to be delivered whether the subject matter is in existence or non-existence at the time of concluding a contract.¹⁶ For example, the sale of flying birds in the sky in which its deliverability to the buyer is unknown.

Contemporary scholars also have offered their conception of *gharar*. For instance, Abdullah Alwi regards *gharar* as the sale of a commodity which does not exist at present.¹⁷ This includes any transaction that is unclear in nature. Siddiqi attributes unclear transactions as those practices which occurred during the Prophet's (s.a.w.) time which has been regarded by him as *gharar*.¹⁸ Kamal et al. cite some examples of *gharar*, such as selling goods that the seller is unable to deliver, selling known or unknown goods against an unknown price, selling goods without proper description and selling goods without specifying the prices; making a contract conditional on an unknown event that happens at an unspecified time, selling goods on the basis of false description and selling goods without allowing the buyer to properly examine the goods.¹⁹

¹² Abdullah @ Alwi Hassan, *Sales and Contracts in Early Islamic Commercial Law*, (Kuala Lumpur: The Other Press, 2007).

¹³ Muḥammad Al-Sarakhsī Abu Bakar, *Kitab al-Mabsut*, (Bayrut: Dar al-Ma'rifah, 1993).

¹⁴ Al-Qararafi, *Al-Dhakhirah Tahqiq Muḥammad Ḥajī* (Bayrut: Dar al-Gharb al-Islami, 1994).

¹⁵ Abu Zakariya Yaḥya Al-Nawawi, *al-Majmu' Sharḥ al-Muhadhdhab*, (Madinah al-Munawwarah: Maktabat al-Salafiyyah, 1925).

¹⁶ Muḥammad ibn Abi Bakr Ibn Qayyim, *Zad al-M'ad Hadyu Khayr al-'Ibad* (Bayrut: Dar al-Fikr. 2003).

¹⁷ Hasan, *Sales*, 66.

¹⁸ Siddiqi, *Riba, Bank Interest and the Rationale of Its Prohibitions*, (Jeddah: Islamic Research and Training Institute, 2004).

¹⁹ Kamal Khir et al., *Islamic Banking: A Practical Perspective* (Petaling Jaya: Pearson Malaysia Sdn. Bhd., 2008).

Gharar has been classified into major (*fahish*) and minor (*yasir*) *gharar*. The former implies grave and the latter refers to an insignificant amount of uncertainty which if tolerated does warrant much dispute.²⁰ The rationales behind the prohibition of *gharar* of both categories, however, are to avoid injustice, inequality, hatred and devouring of other's wealth. Siddiqi argues that the prohibitions are made to prevent unfairness and to realize the *maqasid al-shari'ah* (objectives of *Shari'ah*).²¹ This is also to create satisfaction between both parties and ensure that the income is lawful for consumption.²²

Gambling (*maysir*), in the Islamic parlance, refers to all forms of activities where procurement of money depends entirely on chance or luck; no effort is incorporated in generating the money for instance through a lottery or lucky draw.²³ It is another mode of unjust enrichment which the *Qur'an* (5: 90)²⁴ has explicitly prohibited. Refuting the narrow meaning of *maysir* adopted by some, Siddiqi contends that people fail to distinguish the difference between gambling in games of chance like betting in a horse race, games of cards, spinning the roulette wheel and gambling in the ordinary business life. Similar to old methods of gambling, chances in modern business life involve risks and uncertainties (*gharar*) that one has to guard against, in sales, purchase, investment and production. Contemporary examples of financial risks involving gambling are derivatives from forward sales futures and optional transactions.²⁵ Similarly, Metwally says that the prohibition also covers gambling in forward transactions.²⁶

Muhammad Iqbal also points out that gambling mostly occurs

²⁰ Siddiqi, *Riba, Bank Interest and the Rationale of Its Prohibitions*, (Jeddah: Islamic Research and Training Institute, 2004). Kamal Khir et al., *Islamic Banking...*, 25.

²¹ Siddiqi, *Riba...*, 50.

²² Abdul Rahman, *Contracts...*, 34.

²³ Siddiqi, *Riba...*, 58.

²⁴ *Surah al-Maidah*: 90.

²⁵ Kunhibava and Shanmugam, "Shari'ah and Conventional Law Objections to Derivatives: A Comparison". *Arab Law Quarterly*, Vol. 24, No. 4 (2010): 320.

²⁶ M.M. Metwally, "Economic Consequences of Applying Islamic Principles in Muslim Societies". *International Journal of Social Economics* Vol. 24, No. 7/8/9 (1997): 944.

in insurance products where the concept is like buying and selling a guarantee for safeguarding customers from bad occurrence in the future.²⁷ He adds that excessive *gharar* contained in the subject matter will amount to gambling. For al-Qardawi, gambling brings ill feelings like frustration, disappointment and anger to either party, loss of property without proper exchange, an addiction which could finally cause bankruptcy and a non-productive segment in society.²⁸ In other words, the prohibition of gambling is not because of nature but its resultant effects economically and socially. It directs the saving towards unreal investment, allowing the basis for “liquidity preference” for gambling and encouraging instability in short-term investment. Besides, it creates hatred, enmity and hostility among the society and prevents Muslims from performing prayers and remembering Allah (ﷻ).²⁹

Finally, an Islamic bank avoids temptations to indulge in other unlawful trading activities, such as trading in alcoholic drinks, selling pork and dead animals and manufacturing statues. Islam stresses on the sanctity and validity of contracts in transactions so as to be in line with *Shari’ah*.³⁰ To top it all, Islamic banks must realize the Islamic ideals of brotherhood and cooperation among the contracting parties, develop justice in the economy, and ignite strength in spiritual and moral values as well as preserve the objectives of *Shari’ah*.³¹ As mandated by Bank Negara Malaysia (BNM), all Islamic banks

²⁷ Muhammad Iqbal, *General Takaful Practice: Technical Approach to Eliminate Gharar (Uncertainty), Maysir (Gambling) and Riba (Usury)*, (Jakarta: Gema Insani Press, 2005).

²⁸ Yusuf al-Qardawi, *The Lawful and the Prohibited in Islam*, (London: Al-Birr Foundation, 2003): 281-82.

²⁹ Ahmad Hidayat Buang, *Studies in the Islamic Law of Contracts: The Prohibition of Gharar*, (Kuala Lumpur: International Law Book Service, 2000): 38; Metwally, *Economic Consequence...*, 944-45.

³⁰ Al-Qardawi, *The Lawful and the Prohibited...*, 283-86; Mohd Masum Billah, *Islamic Law of Trade and Finance: Some Contemporary Issues*, (Kuala Lumpur: IUM Press, 2001); Wahbah al-Zuhayli, *Al-Fiqh al-Islami wa Adillatuh* (Bayrut: Dar al-Fikr, 2003).

³¹ Mohd Daud Bakar, “Contracts in Islamic Commercial Law and Their Application in the Modern Islamic Financial System”, in *Essential Readings in Islamic Finance*, ed. Mohd Daud Bakar and Engku Rabiah Adawiah Engku Ali (Kuala Lumpur: CERT Publications Sdn. Bhd, 2008).

operating in Malaysia have to ensure that their operations, transactions, activities and products are in accordance with the prescribed Islamic principles as well as the statutory guidelines imposed by Bank Negara Malaysia (BNM) for compliance; otherwise, the purification of their incomes is needed.

Procurement of *haram* incomes by Islamic Banks in Malaysia

Ideally, Islamic banks should not be involved in unlawful transactions yielding to the procurement of incomes. Islamic banks in practice, however, accrue illegitimate incomes through one or all of the following business ventures:

1-Invalidity of banking products

The earning of banks can be regarded illicit because it deals with invalid products arising from the existence of *Shari'ah* non-compliant contract in the structure of products either by invalid contract combination or inappropriate selection of contract in developing and supporting new products.³² Syed Hussein argues that it is forbidden to combine two contracts in one deal,³³ some example of which include: non-fulfilment of specific pillars of contract, insertion of an alien condition in a contract, interest-based activities, wrong execution of contracts, unlawful business operations, and unlawful documentation in supporting a particular product.³⁴ Combination of contracts, as such, which 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

³² Kabir Hassan and Mervyn K. Lewis, "Product Development and *Shari'ah* Issues in Islamic Finance". *Thunderbird International Business Review* 49, no. 3 (2007): 281–284; Ahcene Lahsasna, *A Mini Guide to Islamic Contracts in Financial Services*, (Kuala Lumpur: Center for Research and Training (CERT), 2012).

³³ Muhammad Burhan Arbouna, "The Combination of Contracts in *Shari'ah*: A Possible Mechanism for Product Development in Islamic Banking and Finance". *Thunderbird International Business Review*, Vol. 49, No. 3 (2007), 341-42.

³⁴ Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, (New York: Kluwer Law International, 2002); Zaharuddin Abdul Rahman, *Wang, Anda dan Islam: Halal dan Haram dalam Kewangan dan Perbankan* (Kuala Lumpur: True wealth Sdn. Bhd., 2008).

contract is prohibited by virtue of *hadiths* as narrated by Malik, Ahmad and Al-Asbahani.³⁵ On the inappropriate selection of types of contract to govern or support the product,³⁶ Engku Rabiah Adawiyah concludes that many forms of contractual agreements that exist in the current practice of Islamic banks are debatable and controversial, for example, *bay' inah*, *tawarruq* and *bay' al-wafa* as they contain *hiyal* (legal tricks to legalize *riba*).³⁷

2- Defective Contract pillars

Another avenue leading to the occurrence of unlawful income is the defects in the pillars of a contract, such as the status of the subject matter (*maḥal al-a'qad* or *maudu' al-'aqd*) in terms of its permissibility, availability and deliverability.³⁸ According to Ahmad Hidayat, *gharar* will occur in the subject matter of a contract if one of these three elements do not exist. He further explains that a subject matter must be free from lack of knowledge (*jahala*) in its specification; character and quantum; free from the inability to

³⁵ There are four *hadiths* that seem to reject the combination of contracts. The first *hadith*, narrated by Malik, disapproves of combining a loan contract and a sale contract. The second *hadith*, reported by Ahmad Ibn Hanbal, disapproves of two sales in one contract (*bay'atayn fī bay'ah*), and similar to this is the *hadith* that prohibits two contracts in one deal (*safqatayn fī safaqah*). *Hadith* reported by Al-Asbahani disapproves a sale that is circumscribed with a condition (*bay' wa al-shart*).

³⁶ Engku Rabiah Adawiyah Engku Ali, “*Bay' Inah* and *Tawarruq*: Mechanisms and Solutions”, in *Essential Readings in Islamic Finance*, ed. Mohd Daud Bakar and Engku Rabiah Adawiyah Engku Ali (Kuala Lumpur: CERT Publications Sdn Bhd, 2008), 165; Abdulazeem Abozaid, “Contemporary Islamic Financing Modes Between Contract Technicalities and Shari'ah Objectives”, *Islamic Economic Studies* 17, no. 2 (2010): 55–75, accessed December 15, 2016, <http://www.irti.org>.

³⁷ Engku Rabiah, *Bay Inah and Tawarruq...*, 165-168.

³⁸ Siddiq Mohammad al-Ameen al-Dhareer, *Al Gharar in Contracts and Its Effect on Contemporary Transaction*, (Saudi Arabia: Islamic Research and Training Institute and Islamic Development Bank, 1997); Mirza Vejjagic, “Future Contracts: Islamic Contract Law Perspectives”, Paper presented at the 5th Islamic Banking, Accounting and Finance Conference 2012 (iBAF 2012), Faculty of Economics and Muamalat (FEM), Universiti Sains Islam Malaysia, October 2-3, 2012; Muhammad Tahir Mansuri, *Islamic Law of Contracts and Business Transactions* (New Delhi: Adam Publishers and Distributors, 2007).

deliver and also the non-existence of non-*Shari'ah*-compliance.³⁹ By subject matter here is meant an asset for which the contract is concluded. Without an asset as a subject matter, a contract is considered null and void in Islamic law. The asset in a subject matter can be either tangible such as goods although not yet in existence, wealth and money or intangible like works, rights and usufruct. Whether the asset is tangible or intangible, the validity of conditions of the assets as a subject matter in a contract needs to be observed for *Shari'ah* compliance purposes. In other words, the subject matter should be permissible, specified or determined, deliverable and existent.⁴⁰

Furthermore, Mohd Daud asserts that subject matter includes the asset and price both of which have to be lawful, existent, deliverable and precisely determined. He points out that aspects inherent in the lawfulness are the condition that the asset must be legally owned, permissible to trade, which means the object must not be prohibited in Islam nor against the norm and morality and also inherent in the condition that the purpose of entering the contract must not violate the concept of justice and fairness.⁴¹ In terms of the existence of subject matter, Islamic law requires the asset, as a subject matter, to be present at the time of a contract.⁴² In addition, the asset must have the capability to be handed over to the other party. According to al-Shaybani, the existence of the subject matter must be associated with the ability to deliver otherwise it would be considered non-existent. Ahmad Hidayat added that Islamic law requires the asset to be well specified to avoid disputes, however, this kind of disputes could be avoided if the buyer is given the right to choose the object he wants to buy.⁴³ This is based on the Hanafi and

³⁹ Buang, *Contracts...*, 113-133.

⁴⁰ Usmani, *Introduction to Islamic Finance*; Al-Zuhayli, *Al-fiqh al-Islami*; Amirul Afif Muhamat, Mohamad Nizam Jaafar and Norfaridah Ali Azizan, "An Empirical Study on Banks' Clients' Sensitivity Towards the Adoption of Arabic Terminology amongst Islamic Banks", *International Journal of Islamic and Middle Eastern Finance and Management*, Vol. 4, No. 4 (2011): 343-354.

⁴¹ Bakar, *Contracts in Islamic Commercial Law*, 51.

⁴² Abu Bakr Mas'ud ibn Ahmad al-Kasani, *Badai' al-Sanai' fi Tartib al-Sharai'*, (al-Qahirah: Dar al-Hadith, 2005), 138-39.

⁴³ Buang, *Contracts...*, 116.

Maliki views that a buyer must be given the right to specify (*khiyar al-ta'yin*) the items he wants to buy.

3-Insertion of invalid conditions to the original

In real businesses of Islamic banks, at times, extra conditions are added to the initial contract which is 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 are against the concept of the product and the rules and regulations of *Shari'ah*. Alien conditions inserted into a contract governing a certain product could generate NHI.⁴⁴ For instance, the capital guarantee is inserted in *mudharabah* product. The insertion could be considered *Shari'ah* non-compliant as it violates the nature of *mudharabah*. This is based on the majority of Muslim scholar's views who hold that there is no capital guarantee in *mudharabah* due to the status of the *mudharib* (entrepreneur) in *mudharabah*. The *mudharib* is like a trustee (*yad amanah*) who will not bear any financial loss unless if it is caused by his negligence and ignorance.⁴⁵ Any condition that conflicts the *muqtada al-'aqd* (requirement of contract) causes the contract to be null and void.⁴⁶ Additionally, such a condition leads to excessive *gharar* because the trustee incurs the loss of effort and loss of money as the *mudharib* has to compensate the capital of the provider.⁴⁷

It is found that many Islamic products offered by Islamic banks fail to comply with this basic principle. The study on *mudharib's* guarantee with reference to the Small Medium Enterprise (SME) found that Islamic banks, in particular, require entrepreneurs of SME to secure the capital invested in *mudharabah*. This is to secure the capital invested given that among the factors contributing

⁴⁴ Asyaf Wajdi et al., "A Framework for Islamic Financial Institution to Deal with Shari'ah Non-compliant Transaction", *ISRA Research Paper*, Vol. 42 (2012): 30.

⁴⁵ Ibn Qudamah, *al-Mughni*, 5; Abu al-Walid Muhammad ibn Ahmad Ibn Rushd, *Bidayah al-mujtahid wa nihayah al-muqtaṣid*, (Bayrut: Dar al-Kutub al-'Ilmiyah, 2004), 22; Al-Mawardi, 2003: 332).

⁴⁶ Taqi al-Din Abu al-'Abbas ibn 'Abd al-Salam Ibn Taymiyah, *al-Halal wa al-Haram wa ba'ḍu Qawaidihima fi al-Muamalat al-Maliyah*, (Bayrut: Maktabah al-matbu'at al-Islamiyah, 1995), 256.

⁴⁷ Ibn Rushd, 2004, 23.

to the failure of SMEs in successfully conducting their businesses are merely due to negligence and corruption in the capital invested. This study further elucidates that for any *mudharabah* to take place, there will be always a mutual risk, meaning that, both the capital provider and entrepreneur should bear the risk of losses; loss of capital for the capital provider and loss of effort and time for the entrepreneur. Thus capital guarantee in *mudharabah* does not show such mutual risk and this inadvertently is against the principles of *mudharabah*.⁴⁸

Apart from *mudharabah*, another example is the imposition of guarantee in BBA⁴⁹ products to secure the obligation of debt and to ensure that customers buy the property after the property has been purchased by the financier through the Property Purchase Agreement (PPA).⁵⁰ As for AITAB⁵¹ and *ijarah*, imposing guarantee in the case of damage and securing default in payment results in invalidity. The profits gained are thus impermissible as this is against the concept of original *ijarah*.⁵²

4-Insertion of late payment fines

Another important issue that could lead to *Shari'ah* non-compliant products is when there is an insertion of late payment charges.⁵³ The majority of Muslim scholars agree that charge on late payment is not permitted because it resembles *riba* where the profits are simply

⁴⁸ Ashraf Md. Hashim and Lokmanul Hakim Hussain, "Jaminan Mudharib di dalam Kontrak Mudharabah Ekuiti Sebagai Asas Pembiayaan: Peluang dan Cabaran," *ISRA* (2011): 18, accessed December 7, 2016 <http://www.ifikr.isra.my>.

⁴⁹ BBA is referred to as the sale and purchase transaction for the financing of an asset on a deferred and installment basis with a preagreed payment period. Refers to Securities commission Resolution, 2007.

⁵⁰ 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).

⁵¹ AITAB is a financing products that enable customers to lease assets from Islamic financial institutions with an option to acquire the leased assets at the end of the lease tenure. Refer to Bank Negara Malaysia Resolutions, 2010.

⁵² AAOIFI, *Shari'ah Standards for Islamic Financial Institutions*, (Bahrain: Accounting and Auditing Organization for Islamic Financial Institutions, 2010).

⁵³ AAOIFI, *Shari'ah standard*; BNM, *Shari'ah Governance Framework for Islamic Finance Institutions* (Kuala Lumpur: Bank Negara Malaysia, 2010), at <http://www.bnm.gov.my>. (Accessed December 7, 2016).

obtained through time value basis. In the current practice of Islamic banking, this condition is inserted into the products like *murabahah*⁵⁴, *istisna*⁵⁵, BBA, *ijarah*⁵⁶ and AITAB to ensure the commitment of paying the instalments. According to Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), the imposition of *gharamah*⁵⁷ (penalty) on the reluctant customers to compensate loss of income or loss due to change of value of the debt currency is not applicable. However, AAOIFI observes that it is applicable to solvent debtors and guarantors as to ensure their commitment to payment with a condition that a clause to give some of the charged amount to charity is made under the supervision of *Shari'ah* committee of the bank.⁵⁸ This is called *ta'widh* (compensation).⁵⁹ Although both are applicable, only *ta'widh* could be considered as income because it is considered an actual loss while *gharamah* must be channeled to charity.⁶⁰ This is because *ta'widh* is stipulated to cover the costs that are related to the late payment while *gharamah* is merely to prevent negligence and to assure the creditors or banks of timely payment and not for income.

The imposition of *gharamah* is necessary for Islamic banks to be applied as one of the solutions for reluctant customers. This imposition is permissible with the condition that it is not compounding in nature and not regarded as the banks' income. Similarly, *ta'widh* is necessary to cover the related cost by the banks

⁵⁴ *Murabahah* refers to a sale and purchase of an asset where the acquisition cost and the mark-up are disclosed to the purchaser. Refer to Bank Negara Malaysia Resolutions, 2010.

⁵⁵ *Istisna`* is a contract of sale and purchase involving manufacturing, producing or constructing a particular asset according to certain terms and specifications as agreed between the seller, the manufacturer/developer and the customer. Refer to Bank Negara Malaysia Resolutions, 2010.

⁵⁶ *Ijarah* refers to a lease or commission contract that involves an exchange of usufruct or benefits of an asset or a service for rent or commission for an agreed period. Refer to Bank Negara Malaysia Resolutions, 2010.

⁵⁷ It is a compensation on the actual loss incurred due to default in payment while the latter is a penalty charged on customers due to delay in making payment irrespective of occurrence of actual loss. Refer to AAOIFI (2010).

⁵⁸ AAOIFI, *Shari'ah Standard*.

⁵⁹ It is a compensation on the actual loss incurred due to default in payment.

⁶⁰ BNM, *Shari'ah Governance Framework*.

with the condition that the imposition is not more than 1% to be considered as the income.

5- Involvement in non-Shari'ah complaint businesses

From the bankers' perspective, under the pressure to stay competitive, the banks may be tempted to engage in *Shari'ah* non-compliant business activities. But this contradicts its aim as "a banking business whose aims and operations do not involve any element which is not approved by Islam."⁶¹ *Shari'ah* Governance Framework for Islamic Finance Institutions issued by BNM clearly underlines the responsibility of Islamic banks to ensure that all their products and services, business dealings, business units, support unit and general operation activities meet the requirements of *Shari'ah*.⁶² All banking business operations should be in accordance with Islamic precepts in all aspects, ranging from product structuring, documentation and contract execution until the business practice through dress codes and image.⁶³ However, some critics, like Zulkifli, believes that some practitioners and bankers do not realize the conflict between *Shari'ah* and legal standing, especially on the letter of offer that involves exchange contracts ('*uqud mu'awadat*').⁶⁴ This claim is supported by Usmani who observes pitfalls emanate from the deficiency of clear perception of relevant rules and principles of *Shari'ah*. He added that this situation, if remains, will lead to weak business operations in Islamic banking as it may lead to further confusion between Islamic banking and conventional banking system, which is based on interest. Worse, it can create a *Shari'ah* non-compliant operation that leads to *haram* income.⁶⁵

A report from *AmTakaful* seems to support the opinion of Usmani where the lack of concern on *Shari'ah* compliance is believed to be the result of the deficient knowledge of Islamic

⁶¹ Islamic Banking Act 1983.

⁶² BNM, *Shari'ah Governance Framework*.

⁶³ Wajdi et al., *Framework for Islamic Financial Institutions*.

⁶⁴ Zulkifli Hasan, "A *Shari'ah* 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* Vol. 1, No.1 (2006): 56-7.

⁶⁵ Usmani, *Introduction to Islamic Finance...*, 9-10.

banking operations, thereby resulting in unclear perception as being claimed. According to the report, *Shari'ah* non-compliant banking business operations have been observed in situations like human errors in executing transaction,⁶⁶ failures to comply with policies and procedures as well as the lack of basic *Shari'ah* knowledge and awareness among the staffs, officers and managers of business divisions.⁶⁷ The report also reveals that the situation of *Shari'ah* non-compliance will cause mistakes in handling Islamic business operations. Another study observes that the lack of concern about *Shari'ah* compliance is due to the low level of ethics, behaviour and attitude among the staffs, officers and managers that tend to operate Islamic banking business in a bad manner. All of these errors, whether intentional or unintentional, may affect the profit generated or at least bring negative and bad implication to the image of Islamic banks. It is suggested that to have a consistent *Shari'ah* compliance in operations of Islamic banking, the recruitment of staffs and officers has to be done in a serious manner with an emphasis on *Shari'ah* commitment, ethics, good behaviour and attitude to develop *Shari'ah* strength from the Islamic bank's internal dimension.⁶⁸

6- Involvement in ribawi business

Islamic bank may also be involved in interest-based activities when dealing with conventional banks. This is due to the pervasive dominance of *ribawi* banking system the world over. This situation, from bankers' point of view, somehow forces Islamic banks to deal with the conventional system through depositing their money and borrowing from conventional banks to operate businesses. But this is contrary to the basic principle of Islam that whatever aids the

⁶⁶ Error execution of transaction such as human error in making disbursement to customers or commence collecting payments from customers is being made before the contracts are concluded. If the *'aqad* is concluded later than the date of disbursement or the contract of agreement is advertently never been perfected the contract is considered not concluded hence any profit derived from that contract is subject to purification until the date of agreement is perfected.

⁶⁷ AmTakaful, 2012.

⁶⁸ BMMB, *Indahnya Perbankan Islam: Proses Pemuatan Syariah dalam Perbankan Islam*, (Kuala Lumpur: Bank Muamalat Malaysia Berhad. 2010): 5, at <http://www.muamalat.com.my> (Accessed December 7, 2016).

unlawful is itself unlawful. For this reason, Prophet Muhammad (ﷺ) had cursed a person who writes the document of interest, a person who witnesses it as well as a person who consumes the interest.⁶⁹ Islam however, with its deep concern for justice, does not confine the punishment on the lender alone, but also on the writer as well as the witness on the interest agreement.

Nevertheless according to some classical jurists, like Ibn Qayyim, at the individual level and small businesses, borrowing money on interest can be justified on the basis of *dharurah* (pressing need). Similarly, if an individual has no choice other than conventional banks to keep his money and keeping it from harm, the dealing is permissible based on the fact that Islam encourages protection of property.⁷⁰ Tapping on this, from bankers' perspective, even Islamic banks as corporate entities at times can be pressed by such a necessity for the sake of staying competitive and survival have to deal with interest-based banking business. Nevertheless, some jurist like al-Qardawi approves such practices based on certain restrictions:⁷¹

- 1- The need should be real as if life will not be possible without meeting it, for example, food, clothes, money and medical treatment, to name a few.
- 2- There should be some limitations on the exact amount needed. For example, if ten ringgit is enough, borrowing eleven ringgit is not allowed.
- 3- If one borrows money on interest, he should find ways to escape from this predicament. If there is no other way, he can continue borrowing but with a serious feeling that he does not like the action.
- 4- He must continue to hate the action and regret doing it until Allah (ﷻ) opens the door for him to escape.

However, we believe, that such restrictions of necessity are actually applicable to all situations of pressing needs and not merely

⁶⁹ Al-Qardawi, *The Lawful and the Prohibited in Islam*, (London: Al-Birr Foundation, 2003).

⁷⁰ 'Abbas Ahmad bin Muhammad Al-Baz, *Ahkam al-Mal al-Haram wa Dawabit al-Intifa' wa al-Tasarruf bihi fi al-Fiqh al-Islami*, (Urdu: Dar al-Nafais, 1999).

⁷¹ Al-Qardawi, *The Lawful and Prohibited in Islam...*

confined to dealing with interest-based activities. However, a person with pressing needs cannot consume the interest since it is a sin and it requires removal. From the discussion, it can be categorized that all the sources of *haram* income in Islamic banks could be the result of either internal or external factors, which are related to the knowledge of the bankers and the situation of pressing needs. Our contention is supported by the very *raison d'etre* of Islamic banks in Malaysia to be *Shari'ah* compliant. This is a concern that some big name in the field also expresses. For instance, Daud Vicary Abdullah⁷², who was the first Managing Director of Hong Leong Islamic Bank, opines that a review on the policies and procedures of Islamic banking business activities, products and services as well as the accounting treatments are necessary. Other than that, staff recruitment, in particular, has to be done with an emphasis on *Shari'ah* knowledge, especially knowledge related to Islamic business transactions. The recruitment process should also consider the Islamic manner of the person.⁷³

It is, therefore, necessary to ensure that the operations of Islamic banks 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 banking 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.⁷⁴

Overall, however, the harsh truth is that in practice, Islamic banking, in fact, has some amount of *haram* income due to some internal and external factors. Now the question is: what is the juristic

⁷² Daud Vicary Abdullah is the Global Leader of Deloitte's Islamic Finance Group. He has been in the Finance and Consulting Industry for more than 35 years, with experience in Asia, Europe, Latin America, and the Middle East. Refer to <http://www.deloitte.com>.

⁷³ BMMB, *Indahnya Perbankan Islam...*, 5.

⁷⁴ BNM, *Shari'ah Governance Framework...*

mechanism to deal with such income? This is an issue to which we turn now.

Juristic Methods of Purifying the unlawful incomes

Classical Muslim jurists have made efforts in clarifying the purification of *haram* income in their respective works. Most of their discussions actually do not directly focus on the purification of *haram* income in Islamic banking but mostly refer to impure money or properties that are obtained through means not acceptable by *Shari'ah* such as stealing, *hirabah* and *ghasb*. Likewise, the discussion generally emphasizes individuals' responsibility of purifying *haram* money or property rather than the responsibility of organizations, institutions, companies, corporations and other entities. However, previous discussions have shed light on the need for *haram* income purification by all Islamic banks in Malaysia.

According to both traditional and contemporary Muslim jurists, all *haram* wealth, profits and money must be purified and could not be kept, utilised and consumed for personal benefit.⁷⁵ 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, his legal 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 channelled to charity for the public interest.⁷⁶

Al-Ghazzali in his discussion on the purification of *haram* money asserts that the impure money or property obtained, for example, through stealing should be returned to the real owner. This is in 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 *haram*

⁷⁵ Mansur ibn Yunus Al-Bahuti, *Kashaf al-Qina' an Matn al-Iqna'*, (Bayrut: Dar al-Kutub al-'Ilmiyah, 1997), 253-257; Muhammad Nabil Ghanayim, *Qadaya Mu'asirah Dirasah Fiqhiyyah Ijma'iyah*, (Al-Qahirah: Dar al-Hidayah. 2003), 146-147.

⁷⁶ Wahbah, *al-Fiqh al-Islami wa Adillatuh...*, 80-102.

money 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 given to charity. He further explains that, if a property is obtained illegally and does not belong to a specific person it belongs to Muslims in general.⁷⁷

Similar to al-Ghazzali, Ibn Taymiyah has outlined Imam Ahmad's and Hanafi's opinions which state that the impure property must be donated to the poor and needy whenever it is hard to find the real owner.⁷⁸ This is said to be the consensus among the four *madhahib*. Other than the poor and needy, the beneficiaries should include *zakah* recipients, persons who help others in performing *hajj* (pilgrimage) and persons who strive in the cause of Allah (ﷻ). The property can also be handed over to suitable authorities that have the ability to manage it with fairness and justice.

In relation to the donation as discussed by Ibn Taymiyah, al-Mawardi in *al-Hawi al-Kabir* 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.⁷⁹ This is based on the Quranic injunction (*Qur'an*, 76: 8)⁸⁰. Al-Mawardi says that non-halal property or money could be disposed to charitable bodies like *bayt al-mal* if the owner is unknown.⁸¹ Al-Bahuti, when discussing on received property (*al-maqbud*) via invalid contracts (void) opines that the property received is invalid. According to him, the treatment of the *haram* property is to return it to the real owner although a contract

⁷⁷ Muhammad bin Muhammad Al-Ghazzali, *Ihya' 'Ulum al-Din*, (Bayrut: Dar al-Ma'rifah, n.d).

⁷⁸ Taqi al-Din Abu al-Abbas ibn Abd al-Salam Ibn Taymiyah, *al-Halal wa al-Haram wa ba'du Qawa'idihima fi al-Muamalat al-Maliyah* (Bayrut: Maktabah al-matbu'at al-Islamiyah, 1995).

⁷⁹ Abu al-Hasan Ali ibn Muhammad ibn Habib Al-Mawardi, *Al-Hawi al-Kabir* (Bayrut: Dar al-Fikr, 1994).

⁸⁰ *Surah al-Insan*: 8. Allah (ﷻ) says, "And they give food in spite of love for it to the needy, the orphan and the captive."

⁸¹ Abu al-Hasan Ali ibn Muhammad ibn Habib Al-Mawardi, *al-Ahkam al-Sultaniyah*, (Al-Qahirah: Dar al-Hadith, 2006).

has been made with the permission of the contracting parties.⁸² This is because the property is still in the ownership of the real owner.

Contemporary Muslim scholars have also discussed purification of *haram* income 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. 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 channelled to charity for the benefits of Muslims. In addition, al-Zarqa further 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 practised by social organizations especially Islamic banks.⁸³

Wahbi Sulayman al-Albani, however, opposes the opinion of al-Zarqa regarding the permissibility of dealing with a *riba*-based bank. According to him, the depositor should immediately withdraw the money from the bank and repent to Allah (ﷻ). 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, no right for personal consumption is bestowed upon him.⁸⁴

Meanwhile, al-Zuhayli opines that the absolute method to free oneself from engaging in *haram* income is by channelling 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 channelled should not be used for building mosques. The use of *haram* income for building mosques and performing pilgrimage, however, is a disputed matter among Muslim scholars.⁸⁵

Another Muslim scholar, Jad al-Haq Ali Jad al-Haq discusses

⁸² Al-Bahuti, *Kashaf al-Qina'*..., 253-257.

⁸³ Al-Zarqa, *Fatawa Mustafa al-Zarqa*..., 123-124.

⁸⁴ Ibid.

⁸⁵ Wahbah, *Al-fiqh al-Islami wa adillatuh*..., 80-102.

the purification of profits generated from *ribawi* transactions. The interest should be purified by channelling 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 property or 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 *haram* money 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 money is for his heirs. If the heirs are absent, waiting for their presence and giving them all the profits accrued from the *money* is most required. In a situation where the *haram* money 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 channelled for Muslims' benefits.⁸⁶

Likewise, Ghanayim maintains that illegal property possessed by an individual requires purification by returning it to the real owner or giving compensation in case the property is damaged. He adds that regarding income which is mixed with *ribawi* transactions, the identified portion of non-*halal* money or property should be purified through a donation to suitable authorities for the benefit of all Muslims.⁸⁷

Accordingly, both classical and modern jurists briefly outline what should be done with haram incomes which Islamic banks procure from an Islamic point of view. This has been contextualized in Malaysian Islamic banks which we have detailed in another study.

Conclusion

Haram income in Islamic banking procured through various objectionable business activities, such as invalidity of contracts that govern certain products, contracts that do not fulfil the pillars and the conditions, unlawful business banking operations and the interest received from conventional banks. Additionally, the development of

⁸⁶ Jad al-Haq Ali Jad Al-Haq, *Buhuth wa Fatawa Islamiyyah fi Qadaya Mu'asirah* (al-Qahirah: Dar al-Hadith, 2005).

⁸⁷ Ghanayim, *Qadaya Mu'asirah...*, 146-147.

a new product which involves the combination of more than one contract is another venture which can yield *haram* income if the rules and regulations for combining the contracts are not fulfilled. Contracting parties who are engaged in a contract should observe the pillars and conditions stipulated on each pillar for validity. Some of the contracts applied in Islamic banking are debatable and require clear Islamic rulings to determine the status of legality. Only after confirming the status, the existence of *haram* income can be identified. The identification of such income is very crucial for the purification process. However, it depends on the seriousness of the Islamic banks to undertake the process of purging non-*halal* incomes and upholding the principles of Islamic corporate governance in their operational procedures.

TRANSLITERATION TABLE

CONSONANTS

Ar=Arabic, Pr=Persian, OT=Ottoman Turkish, Ur=Urdu

| Ar | Pr | OT | UR | Ar | Pr | OT | UR | Ar | Pr | OT | UR | |
|----|----|----|----|----|----|-----|-----|----|-----------------|-----|----|-----------------|
| ء | ' | ' | ' | ز | z | z | z | گ | — | g | g | g |
| ب | b | b | b | ژ | — | — | ʀ | ل | l | l | l | l |
| پ | p | p | p | ژ | — | zh | j | م | m | m | m | m |
| ت | t | t | t | س | s | s | s | ن | n | n | n | n |
| ث | — | — | ṭ | ش | sh | sh | ʃ | ه | h | h | h' | h' |
| ث | th | th | th | ص | ṣ | ṣ | ʃ | و | w | v/u | v | v/u |
| ج | j | j | c | ض | ḏ | ḏ | ḏ | ی | y | y | y | y |
| چ | — | ch | çh | ط | ṭ | ṭ | ṭ | ة | -ah | — | — | -a ² |
| ح | ḥ | ḥ | ḥ | ظ | ẓ | ẓ | ẓ | ال | al ³ | — | — | — |
| خ | kh | kh | kh | ع | ' | ' | ' | | | | | |
| د | d | d | d | غ | gh | gh | ğh | | | | | |
| ڈ | — | — | d | ف | f | f | f | | | | | |
| ذ | dh | dh | dh | ق | q | q | k | | | | | |
| ر | r | r | r | ك | k | k/g | k/ñ | | | | | |

¹ – when not final
² – at in construct state
³ – (article) al - or l-

VOWELS

| | Arabic and Persian | Urdu | Ottoman Turkish |
|------------|--------------------|---|-------------------|
| Long | ا | ā | ā |
| | آ | Ā | — |
| | و | ū | ū |
| | ي | ī | ī |
| Doubled | ي | īy (final form ī) | īy (final form ī) |
| | و | uww (final form ū) uvv (for Persian) | uvv |
| Diphthongs | و | au or aw | ev |
| | ی | ai or ay | ey |
| Short | ا | a | a or e |
| | ا | u | u or ū |
| | ا | i | o or ö |
| | ا | i | i |

URDU ASPIRATED SOUNDS

For aspirated sounds not used in Arabic, Persian, and Turkish add h after the letter and underline both the letters e.g. چ jh گ gh

For Ottoman Turkish, modern Turkish orthography may be used.

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