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- **Assignment islamic jurisprudence ii**
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- **Mid term**
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Islamic Law of Contract

Shariah restrictions on certain financial and trade transactions is the raison d'être for the emergence of Islamic banking. It is, therefore, important for any student of Islamic banking to grasp the basic elements of the Islamic law of contract.

Meaning of contract

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Contract in Shari'ah, Aqd, means a tie or a knot binding two parties together. The contract is a declaration of offer and acceptance. Unlike English law which developed through the work of judges, Islamic law of contract developed through the work of Fugaha (jurists), based on the principle laid down by the Quran and the narrations from the Prophet (P.B.U.H).

The Qur'an contains a large number of specific contracts, and axioms of wide application m the area of contractual relationships. These include various commercial contracts such as sale, hire, guarantee, security and deposits. In some of the verses of the Qur'an where such contracts are stated, foundation for rules of new contracts were initiated, in others recognition and legitimization of already existing practice at the advent of Islam are confirmed.

The Islamic contract law is wider in scope than the English or French because it embraces some dispositions which are not considered "contract" in either English or French legal systems. Endowment is an example of such dispositions.

Contrary to some western writings, Shari'ah does have a general theory of contract. Therefore, Shari'ah has facilities to accommodate uncatalogued agreements. Contracting an arrangement that is not falling in the categories of recognized nominate contracts is not forbidden in Shari'ah. Furthermore, conditions attached to an irrevocable contract have been used by Muslims to extend the applications of such contracts.

Moreover, declaration of intention and consenting is central to the law of contract in Shari'ah. Though contracts in Shari'ah are not as consensualist as ones in English law, consenting is central to the law of contract in Islam, for without consent a contract will not have a binding force. Furthermore, the intention to create a contract is actually more important in Shari'ah than the formalities of a contract. This shows that Shari'ah capability to respond to people's needs is limited by people's ability to understand its rules.

Classification of contracts in Shari'ah

There are several classification for contracts in Shari'ah. What we are concerned with, however, are those doing with Islamic banking.

Definitive and suspensive contracts

A contract is definitive when the offer and acceptance are both categorical and the contract is validly concluded. A contract is suspensive when the offer and acceptance are kept in suspense i.e. for future effect. The latter is not permitted in Shari'ah, particularly in sale contracts. Hire contracts, to majority of scholars, may be suspensive.

Binding (or obligatory) and facultative (or permissible)

Some contracts are binding, Lazim, once concluded they cannot be revoked except by mutual consent of the two parties. Some are facultative, Jaiez, which can be revoked by either party, and in some cases by a given party.

An example of the binding contracts are the contracts of sale, hire and lease... etc. An example of the permissible contracts are agency, deposit, and Mudarabah. These can be revoked by either party any time. While the contract of security (rahn) can be revoked any time, this can only be done by the beneficiary, i.e. the creditor.

Some contracts start as facultative and then turn to be binding such as donation. Donation becomes binding only after delivery. Distinguishing obligate from facultative is important. However, such classification is itself subject to Ijtihad. For example, the Mudarabah contract in Islamic banking is no longer facultative but binding for the duration of the contract. Contemporary jurists think that it was quite logical for Mudarabah to by facultative in the old days since it had no time limit. Once a maturity has been agreed on by the two parties, it makes no sense to give either one the right, still, to revoke any time without the consent of the other. Furthermore, most investment opportunities require time, which means that, unlike the old days, investment assets cannot be liquidated before maturity.

Correct and corrupt contracts

A contract is correct (sahih) when it is valid, effective and enforceable. A contract is considered corrupt (faced) when it is none of the above and referred to as a void one. Some contracts are salvageable when they become corrupt. For example if the reason for corruption is a non-permissible condition in the contract, then removal of such condition will correct it. For example a Mudarabah contract with a condition that the agent guarantees capital for rubb-ul-mal is corrupt. It can be valid again by just removing this condition. If the reason for corruption is the object of the contract, like purchase of non-permissible goods such as wine then it can't be salvaged.

Contracts of Exchange and Contracts of Gratuities

Contracts of exchange are those where the two parties interchange price on the one hand and a good or a service sold on the other. Sale, hire...etc. are all examples of exchange contracts. Contracts of gratuities are those which are done for benevolence purposes such as donation which is considered in Shari'ah a contract. Distinction between the two is important particularly when Gharar is present.

Specific or nominate contracts

Shari'ah includes certain pre-designed contracts derived from the Quran, Sunnah and Ijma. These are, basically, sale hire, agency, guarantee, donation, partnership and Mudarabah.

Islamic Shari'ah, nevertheless does have its own theory of contract and hence, allows contracting arrangement not falling in the categories of recognized nominate contracts, given that they are within the parameters of Shari'ah. A new contract may not be completely new, but an amalgamation of a number of nominate contracts. The modern Murabaha contract may be considered an example.

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Five Main Contracts in Islamic Finance

For Islamic banks to a make profit and to satisfy the borrowers' needs of cash, they have to conduct transactions that do not violate Islamic rules by looking for allowed contracts that can achieve the required goal. Mostly, they are based on sale and purchase transactions, accompanied by a degree of risk.

There are five main contracts in Islamic finance: Mudarabah, Musharakah, Murabahah, Ijarah and Salam:

i. Profit and loss sharing (Mudarabah): is a contract between two parties; one provides the capital and the other provides the labor to form a partnership to share the profits by certain agreed proportions.

ii. Joint venture (Musharakah): is a financial contract between two or many parties to establish a commercial enterprise based on capital and labor. The profit and loss are shared at an agreed proportion according to the amount of contribution.

iii. Cost plus (Murabahah): refers to a sale of a good or property with an agreed profit against a deferred or a lump sum payment. There are two contracts in Murabahah: the first contract is between the client and the bank, whereas the second contract is between the bank and supplier. The client (purchaser) orders a certain commodity through the bank, the bank then buys the commodity from the supplier and sells it to the client with specified profit whereby the client can make a lump sum or a deferred payment to the bank.

iv. Leasing (Ijarah): in which two parties are involved therein: the lessee and leaser. The leaser (bank) is the real owner of the asset or property and it is rented out to the lessee until full payment is received. The lessee has the option to keep the asset at contract maturity or give it back to the bank. If all payments are received, the lessee can keep the asset but at a higher price than the usual asset price.

v. Salam: is another contract where full payment for a good is paid in advance but the delivery of the good is made at an agreed future date.

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Source: Characteristics of GCC Islamic Banks Investment in Malaysia, Ali Abusalah Elmabrok Mohammedd