

PROHIBITORY TRANSACTIONS OF SUKUK ASSETS: THE SHARI'AH ANALYSIS WITH REFERENCE TO ISLAMIC CAPITAL MARKETS

AUWAL ADAM SAAD* AND ABDUL HASEEB ANSARI**

The paper discusses issues related to prohibitory transactions associated to Sukuk issuance in Islamic capital markets. The paper is elaborated on the principles of prohibitory transactions such as gambling, riba (usury), gharar (excessive risk) non-halal products and services. The paper discussed issues related to future assets and services in which Islamic jurists have difference of opinion in accepting part of it as genuine Islamic assets for Sukuk transaction purposes. The paper also touches issues of the prohibitions and purification of income related to an Islamic financial institution. The paper suggests that rules related to Islamic contracts of sale such as bay' Muajjal, Murabahah, Salam, Istithna', Ijarah should be strictly followed in any related sukuk issuance. Likewise partnership related contracts, such as Musharakah, Mudarabah, Wakalah and so on. It is also advised that Sukuk issuances must be strictly observing the Shari'ah principles of prohibitory transactions; couple with principle of purification of income where applicable.

1. Introduction

Generally, according to the *Shari'ah* law everything is permissible except what is prohibited either by the Qur'an and *Sunnah* (Prophetic traditions). Therefore, all types of contracts are permissible except where it is prohibited by law. The Almighty Allah (swt) said in the Holy Qur'an "Oh you who believe! Intoxicants, Gambling, *Ansab*, and *Azlam* are only an abomination of *Shaytan's* handiwork; So avoid that in order that you might be successful" (Qur'an 5:90) Imam Ahmad recorded that Ibn 'Umar said that the messenger of Allah said: "Ten Matters related to *Khamr* were cursed, *Khamr* itself was cursed, whoever drinks it, its server, seller, buyer, brewer, who ask

* Teaching Fellow, School of Management, USM, Malaysia

** Professor, A. I. Faculty of Laws, International Islamic University Malaysia, Malaysia

for it to be brewed, whoever carries it, whomever it is carried to and whoever consumes it or collect it price”

1.1.Principles of Prohibitory Transactions

Shari'ah prohibits transactions on anything associated to liquor, gambling,¹ pork, financial services based on *riba* (usury) and *gharar* (excessive risk), the manufacture or sale of *non-halal* products, conventional insurance, the manufacture or sale of tobacco-based products or related products, prohibited entertainment activities, and other non-permissible activities according to the *Shari'ah*. The prohibition of such items and activities is clearly understood; the evil effects of gambling, prostitution, and alcohol are clear. Interest (*riba*), however, has become the main issue in the twenty-first century's economy; its evil effects influenced nearly each and every person in the world.

Structuring *Sukuk* involves the sale of the asset or its usufruct, the basic rules of the Islamic contract of sale is that the item sold has to be *Shari'ah* compliant and in existence and the seller must be able to deliver the sold item as required by the contract. However, *Sukuk* assets involve tangible and intangible assets, future assets and services in which Islamic jurists have maintained differences of opinion in accepting some of them as genuine Islamic assets for securitization. Those who reject them argue that; futures contracts are unlawful because some *Shari'ah* principles stress that purchase or sale cannot be affected by a future date. On the other hand, other scholars have objected to that, stressing that some of the concepts and conditions of such trades are exactly the same as those future contracts regulated by the Prophet (saw) in a *Hadith*: “He who makes a *Salaf* (forward trade) should do so for a specific quality, specific weight and for a specific period of time”.²

The Islamic Jurists have agreed that weighted foodstuff could be sold in futures contract if it fulfills the requirements mentioned in this *Hadith*, i.e. the weight and quantity must be acknowledged, and the time must be specified.³ Another version of the *Hadith* was narrated by Nafi' through 'Abdullah Ibn 'Umar who said: “whosoever wanted to sell a foodstuff shouldn't do so until he takes possession of it”⁴

Prohibitory Transactions of Sukuk Assets/ 101

It is important to note here that a difference of opinion exist on the issue where the items are foodstuff but are not sold through weighing or whether the ruling includes all other items other than foodstuff.

Malik bin Anas and Auza'i maintained that it is permissible to sell before taking possession of an item which is not food on its own, such as onion, carrots and so on.⁵ They also legalized selling foodstuff before its possession if it is sold *Jazzafan* (without weighing).⁶ However, Abu *Thawr*, Imam Ahmad bin *Hanbal* and Daawud al-Zahiri maintained that all types of foodstuffs shouldn't be sold before physical possession and also any other item which is not foodstuff could be sold before physical possession.⁷ However, Imam Abu *Hanifah* and *Shafii'* have opposed all the opinions and have maintained that all items including foodstuff and non foodstuff should not be sold before possession.⁸ This is also the opinion of Ibn 'Abbas and Jabir bin 'Abdillah, Ibn Abbas said: "Everything to me is like food on this matter."⁹ Another opinion credited to Imam Abu 'Umar (Ibn 'Abdil-bar) was that some other jurists maintained the opinion that each and every item which is sold through weighing including foodstuff should not be sold without custody, like-wise for other items including foodstuff. Non-foodstuff which are not sold through weighing could be sold before their possession.¹⁰

Malik bin Anas was narrated to have been said: *Sukuk* papers were introduced in the era of *Marwan bin Hakam* for foodstuff benefits. Then people started selling such *Sukuk* papers to third parties ahead of its custody. *Zaid bin Thabit* along with another companion went to Marwan and said, "Oh Marwan, are you legalizing trading in *riba*? He said, no I seek refuge to Allah from that, what is happening? They said people brought these *Sukuk* and started trading them before taking possession of the subject matter. Marwan took the *Sukuk* from the third parties and returned them back to their original owners.¹¹ Abu 'Umar said this is exactly the *Madhab* of Imam *Malik*, the first *Sukuk* issuance was based on the military compensation¹² which is given to them as their portion of *Fai*.¹³ The first owners of the *Sukuk* were not to be blamed for selling the *Sukuk* to second parties before possession, because their *Sukuk* was not based on a sale contract.¹⁴ However, the second owners of the *Sukuk* were

blamed by the companion *Zaid bin Thabit* because they were selling the *Sukuk* to third parties before possession.¹⁵ This is contrary to the *hadith* “whosoever bought a foodstuff shouldn’t sell it ahead of custody.”¹⁶

1.2. *Al-Muharram li-dhatih* (prohibited items)

Al-Muharram li-dhatih is an item which is prohibited by Allah the Almighty or by the Prophet (peace be upon him.) Some items are prohibited entirely; both their physical forms and usufruct are prohibited, whereas some items were partially prohibited, such the prohibition of their physical forms but not their usufruct. Swine, Blood and dead animals were prohibited by Allah the Almighty. In Surat al-Ma’idah Allah the Almighty said: “Prohibited to you are dead animals, blood, the flesh of swine, and that which has been dedicated to other than Allah, and those animals killed by strangling or by a violent blow or by a head-long fall or by the goring of horns, and those from which a wild animal has eaten except what you are able to slaughter before its death”¹⁷ There are some exceptions related to blood and dead animals. Prophet Muhammad (saw) was reported to have said in a *hadith* “Two kinds of bloods and two kinds of dead animals are lawful for us, the dead animals are locusts and whale-fish and the bloods are spleen and liver.”¹⁸

It was narrated by Jabir bin ‘Abdullah (may Allah be pleased with him) said: In the year of the conquest of *Makkah*, I heard the Prophet of Allah (saw) saying, “Allah and His messenger made the trade of alcohol illegal, likewise liquor, dead animals, pigs and idols” The people asked, “O Allah’s messenger! What about the fat of dead animals, for it was used for greasing the boats and the hides, and people used it for light?” He said: “No it is illegal.” Allah’s messenger further said: “May Allah curse the Jews, for Allah made the fat of animals illegal for them, yet they melted the fat and sold it and ate its price.”¹⁹ It is very important to mention that the Prophet of Allah in this *hadith* doesn’t prohibit the use of fat of dead animals, but rather he prohibits the sale of the fat of dead animals. Therefore the use of the fat of dead animals is still legal and permissible.

1.3. *Muharram li-ghairihi* (prohibited for external causes)

Al-Muharram li-ghairihi is an item which is permissible. However, it can be prohibited due to its association with other prohibited mechanisms or activities. For example money, coins or any valuable item such as gold, silver and so on are *halal* and permissible for anyone to have them use them and possess them. However, money and its associate can be prohibited to a person if the medium of possessing them is prohibited by *Shari'ah*, such as snatching, stealing, deception, *riba*, oppression or any other illegal approach of acquiring them.

1.4. Purification of income generated from prohibitory transaction

Purification of income is a mechanism used by Islamic financial institutions to purify their income from an unavoidable *riba* or any other unlawful income. The issue of inclusion mixed companies to the list of *Shari'ah* compliant securities is one of the triggering factors of the issue of purification and cleansing of generated income, and many regulators provide some Islamic benchmark to make sure that the Financial institutions involve in Islamic transactions are strictly executing the *Shari'ah* compliant activities. The Islamic Financial Institutions look at it as necessary to create a special benchmark in order to protect the larger compliant amount which is mixed with a small non-compliant one.²⁰ However, scholars in the past did not provide any benchmark, but the contemporary scholars do. This is to provide a basis for precaution measures against *haram* related contracts.

However, it is not permissible for a person to rent out his house for prostitution, drinking or *riba* activity. Allah the Almighty says: "but do not cooperate in sin and oppression"²¹ But, there is a different approach in terms of *muharram li-ghairihi* when it comes to the issue of purification of income related to the income earning of a party to an Islamic contract. Purification of income for *ijarah* receivables for instance is not applicable. This is where a contracting party is involved in *riba* trading, gambling or any other contract prohibited by *Shari'ah*, which has no connection with the *ijarah* contract. These external activities will not affect the contract because; both the *ijarah* contract

and the *ijarah* usufruct are *Shari'ah* compliant. The involvement of the contacting party's money which is amalgamated with *halal* and *haram* will not affect the *ijarah* contract. If we are to investigate the compatibility of the income of the people we contract with, we will put ourselves in difficulty. While Allah the Almighty said: "And Allah has not placed upon you in the religion any difficulty"²²

Furthermore, the Prophet of Allah (saw) used to contract with Jews despite their involvement in *riba*. Allah the Almighty says: "And for their taking of usury while they had been forbidden from it, and their consuming of the people's wealth unjustly"²³ Despite this, the Prophet of Allah was reported to have engaged in a contract with Jews as reported by 'Aisha (ra) said: "The Prophet of Allah dies while his armor-cloth was given to a Jew as collateral for thirty gram of barley."²⁴ The Prophet of Allah (saw) has collected *jizya* (tribute) from Jews of *taima*, *wadilqura*, *bahaz*, *tanukh* and *dayi*.²⁵ The Prophet (saw) collected the tribute from Jews and others without purifying or investigating whether their income is *halal* or *haram*. Therefore, it is not applicable today to instigate the purification of income of a party to a contract of sale or services under *Shari'ah* law. Simply because the Prophet did not do it, and if it is necessary the Prophet must have done it before us, thus we would have to stop where he stops.

However, if an Islamic financial institution involves in some *non-halal* transaction or activity, a benchmark is provided by the Malaysian scholars so as to accept it as *Shari'ah* compliant if it those not exceed the benchmark, but if it exceed the benchmark then it is not permissible. Firstly, five percent benchmark; this benchmark is used to assess the level of mixed contributions from the activities that are clearly prohibited such as *riba* (interest-based companies like conventional banks), gambling, liquor and pork. Secondly, Ten percent benchmark, this benchmark is used to assess the level of mixed contributions from the activities that involve the element of '*umum balwa* which is a prohibited element affecting most people and difficult to avoid. An example of such a contribution is the interest income from fixed deposits in conventional banks. This benchmark is also used for tobacco-related activities. Thirdly, twenty percent

benchmark, this benchmark is used to assess the level of contribution from mixed rental payment from *Shari'ah* non-compliant activities such as the rental payment from the premise that involved in gambling, sale of liquor etc. Lastly, this benchmark is used to assess the level of mixed contributions from the activities that are generally permissible according to *Shari'ah* and have an element of *Maslahah* to the public, but there are other elements that may affect the *Shari'ah* status of these activities. Among the activities that belong to this benchmark are hotel and resort operations, share trading, stock broking and others, as these activities may also involve other activities that are deemed non-permissible according to the *Shari'ah*.²⁶

1.5. Conclusion

For *Shari'ah* compliant *Sukuk* issuances there must be a strict adherence to the Islamic contract selected for the *Sukuk* documentation purposes. The contracts based on debt such as *Bai Muajjal*, *Murabahah*, *Salam*, *Istithina'*, *Ijarah* are acceptable Islamic contracts. These contracts could be used for *Sukuk* issuances with strict adherence to their rules based on *Shari'ah*. The contract based on equity principles such as *Musharakah*, *Mudarabah* and likewise agency principle of *wakalah* are also acceptable *Shari'ah* contracts and suitable for *Sukuk* issuances, given that the *Sukuk* involves various transactions of goods and properties.

Companies whose assets are foodstuff should not sell their *Sukuk* in the secondary market prior to physical possession of the asset.

The *Sukuk* issuance process must observe the *Shari'ah* principles of prohibitory transactions. *Shari'ah* prohibits *al-Muharram li dhatihi* such as anything associated with liquor, gambling, pork, prostitution, sale of blood and dead animals. And *al-Muharram li ghairihi* such as, financial services based on *riba* (interest) and *gharar* (excessive risk). The principles of purification of income applicable to institutions that wish to clean income which is amalgamated with *halal* and unavoidable non *halal* profits, which is earned without the intention of the institution. However, purification of income is not relevant to the income generated by a *halal* institution, which contracted with another party whose income was based on *non-halal*

activity; this is because the Prophet (saw) contracted with Jews despite their involvement in usury and other non-*halal* activities.

Notes

1. The Almighty Allah said in the Holy Qur'an "Oh you who believe! Intoxicants, Gambling, *Ansab*, and *Azlam* are only an abomination of Shytan's handiwork. So avoid that in order that you might be successful" (Surat Maidah 90) ImÉm Ahmad recorded that Ibn 'Umar said that the messenger of Allah said: "Ten Matters related to Khamr were cursed, Khamr itself was cursed, whoever drinks it, its server, Seller, buyer, brewer, who ask for it to be brewed, whoever carries it, whomever it is carried to and whoever consume its price"
2. Imam Al -Bukhari, "*Ajamiu Sahib*" Hadith 2240 vol.3 p.111.
3. Ibn Abdul Bar, "*Alistizkar Aljami limazahib Fuqaha'il Amsar*" vol.6 p. 330.
4. *Muwattah Malik* Hadith 1310 reported by Yahya bin Layth.
5. Ibid.
6. Ibid.
7. Ibid.
8. Ibid.
9. Ibn Abdul Bar, said that they relied on the *hadith* narrated that the Prophet (Peace be upon him) said:"You should not be profited from the things you do not guaranty" and to them this includes everything. However Imam Malik Bin Anas uses this hadith on the Foodstuff that could be weighted only. *Alistizkar* vol. 6 p.331
10. Ibn Abdul Bar, "*Al-istidhkar Aljami li madbahib Fuqah'il Amsar*" vol.6 p.331
11. Ibid., p.333
12. Ibid.
13. Ibid.
14. Ibn 'Abdil Bar, "*Al-Istidhkar Aljami li mazahib Fuqaha'il Amsar*" Vol.6 p.334
15. Ibid.
16. *Muwatta* Imam Malik, Hadith 1311 reported by Yahya bin Layth.

Prohibitory Transactions of Sukuk Assets/ 107

17. Qur'an 5: 3
18. Imam Ahmad bin hanbal "*kitab al-musnad*" hadith 5723 vol.2 p.97
19. *Sahih al-bukhary*, Hadith no.2236, chapter 112 the sale of the dead animals and idols.
20. Securities commission of Malaysia, "Resolutions of the Securities Commission *Shari'ah* Advisory Council" p.159
21. Qur'an 5:2
22. Qur'an 22:78
23. Qur'an 4:161
24. *Sahih al-bukhary*, Hadith no. 2916
25. Ali bin naif al-shuhud, "*al-Mufassal fi sharhi hadith man baddala dinahu faqtuluh*" *Shamilah*, vol.2 p.148
26. Securities Commission of Malaysia, (2011) List of *Shari'ah* –Complaint Securities by the *Shari'ah* advisory council of the Commission. Suruhanjaya Security" p.15-17.