

An Analysis of the Ijaarah Muntahiyah Bittamleek Contract

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Abstract

Ijaarah Muntahiyah Bittamleek is a viable mode of acquiring commodities, such as real estate. Ijaarah is a contract of exchange of an object, means of transportation, office space, residence, land etc., involving two parties Ijaarah contract is a religiously-sound contract, deriving its legitimacy from the Quran [Surah al-Qasas: v.26, Surah al-Kahf: v.77]. Ijaarah Muntahiyah Bittamleek contract is not fundamentally different than a 'standard' Ijaarah contract, except that the lessor promises to transfer ownership to the lessee at the end of term. Shariah requirements that must be observed by Islamic Financial Institutions for the viability of a typical Ijaarah Muntahiyah Bittamleek contract. However, there are risks associated with Ijaarah Muntahiyah Bittamleek contracts as well as Ijarah contracts.

Keywords: Ijarah; Islamic Finance; Riba; Interest

Paper Type: Theoretical

Mentor: Dr. Main Alqudah

Introduction

In a highly dynamic, constantly-changing financial world, the ability to own big ticket items is beyond the means of the average person. Most consumers are not in a position to purchase a house or automobile by paying its value in cash, and completing the sales transaction on-the-spot. Mortgages, leasing and rentals are alternative means to acquiring high dollar goods. From car rentals, to rent-to-own furniture and electronics, to upscale rentals of clothing and accessories, renting is part of the twenty-first century paradigm. However, many of these transactions are not Shariah compliant.

Muslim consumers are under the authority of Allah and are required to conduct their affairs according to the Shariah brought forth by His Prophet. A Muslim is allowed to participate in any kind of a financial transaction, as long as, it does not violate a few, basic, clearly-stipulated regulations present in the Quran and the authentic Sunnah of the Prophet. As such, interest-based or interest-inclusive transactions are abhorred and prohibited, whereas any trade and business activities that generate fair and legitimate profits are encouraged. This reinforces the close link between financial and productive flows which underpin Islamic finance, thereby insulating the Islamic financial system from risks associated with excessive leverage and speculative financial activities (Vejjagic, 2014).

Thus, Islamic Financial Institutions have introduced a number of Shariah-compliant modes for home financing such as al-Bay' Bithaman Ajil (BBA), the Musharakah Mutanaqisah Partnerships (MMP) and Ijaarah Muntahiyyah Bittamleek (Hossain, 2005). While al-Bay' Bithaman Ajil has seen a steady stream of criticism directed towards it, Musharakah Mutanaqisah Partnerships and Ijaarah Muntahiyyah Bittamleek seem to have received widespread acceptance by the Fuqaha (Kamali, 2007).

Ijaarah Muntahiyyah Bittamleek

Before Ijaarah Muntahiyyah Bittamleek is discussed, the term Ijaarah and its technical usage in Shariah need to be understood. Linguistically, Ijaarah means to provide an asset on a rent/lease term. From the perspective of Shariah, lease could also include wages paid to a person for services rendered. It is the 'temporary' transfer of the usufruct of an object or a property in

lieu of financial compensation. Conceptually, Ijaarah is a contract of exchange of an object, means of transportation, office space, residence, land etc., involving two parties. The lessor (the owner of the asset) provides the asset for use by the lessee, for a financial gain. Fundamentally, there is no transfer of ownership from the lessor to the lessee.

The Ijaarah contract is a religiously-sound contract, deriving its legitimacy from the Quran [Surah al-Qasas: v.26, Surah al-Kahf: v.77], from the authentic hadeeth of the Prophet, "give a worker his wages before his sweat has dried"[Sunan Ibn Maajah 2/817] (among others), and from the consensus of the scholars from every generation of Muslims. Even from basic human reasoning, an Ijaarah contract makes sense, since not every person has the ability to own all the things that he needs and/or desires.

Over time, the Ijaarah contract has become extremely complex due to introduction of various clauses and stipulations, which have given rise to many variations of an Ijaarah contract. As long as the basic structure of the Ijaarah contract remains intact, these variations can be acceptable (provided they are not in violation of the principles of Islamic finance).

An Ijaarah contract is a binding contract, inviolable, unalterable without the express permission of both concerned parties. It has a specific duration, commencing (usually) on the day of its execution and concluding on the date mentioned in the contract. The period of lease may be shortened and extended, provided both the lessor and the lessee agree to that change.

No payment is due on behalf of the lessee until he receives the asset in full and the shape, manner and quantity stipulated within the contract. If the lessor fails to provide the asset on the specified date, the rent needs to be adjusted according to the delay in delivery.

An advance payment on the lease is acceptable as long as both parties agree to it. Also, the lessor can enter into contracts of many successive lease periods with the same lessee or with others, provided the periods of exchange do not overlap. On the other hand, an Ijaarah contract may contain multiple lessees being entitled to the same usufruct of the asset, without specifying a time period for every lessee.

A lessee has the privilege of providing the recently acquired asset for lease to other lessees, thereby assuming the role of a lessor and entering into a sub-lease contract with them. The Ijaarah Muntahiyah Bittamleek contract is not fundamentally different than a 'standard' Ijaarah contract, except that the lessor promises to transfer ownership to the lessee at the end of term. Of importance to note is that an Ijaarah Muntahiyah Bittamleek contract is not the same as hire-to-purchase contracts on offer from conventional finance banks; this is due to the fact that the transfer of ownership clause is stipulated within the same contract, and ownership transfers over to the lessee upon payment of the last installment. On the other hand, an Ijaarah Muntahiyah Bittamleek contract would not automatically convert into a sale contract at the payment of the final lease installment. The transfer of ownership, based on a promise from the lessor, can be accomplished by either drawing up a separate sales contract between the lessor and the lessee or a transfer of ownership based upon a charitable donation or a gift from the lessor. It can also be accomplished by advancing the remaining amount of rental, by paying the actual value of the leased property.

If any of the methods described above are utilized the promise to transfer ownership is a binding promise on the lessor. Having said that, the option to accept or decline the sale still rests with the lessee. A bi-partisan promise is prohibited in an Ijaarah Muntahiyah Bittamleek contract.

Acquisition of the Asset by the Islamic Financial Institution

Islamic Financial Institution should acquire the specific asset prior to contracting the lease with its customer. If the financial institution has acquired (or is already in possession of) the asset beforehand, which should be the case, an Ijarah contract can be concluded between the lessor and the customer. Conversely, if the asset has not been fully acquired by

the financial institution (i.e. it is not the owner yet), and it goes ahead with the contract, such a contract shall be deemed invalid. The basis for this prohibition exists in the hadith of the Prophet in which he prohibited one from selling what he does not own [Sunan Abu Dawud 3/283].

An asset may be acquired by the financial institution from a customer and then leased out to the same customer. This is permissible since such a transaction does not involve an *'ainah* sale. This transaction shall be not stipulated within the purchase contract by which the financial institution acquires the asset.

A financial institution may jointly acquire a property with the customer. The customer can then lease the institution's share of the asset from the institution itself. The customer can even serve in the capacity of an agent while trying to procure and/or acquire the asset for the financial institution, which is extending him the lease for that very asset, provided that the ownership is transferred firmly into the hands of the institution. The customer can then go ahead and lease that asset. Though such an agency is permissible, it is certainly undesirable. The reason for preferring that the agent be someone other than the customer is to avoid fictitious transactions being contracted, and any conflict of interest.

Even if the title for the asset is not registered in the name of the financial institution making the purchase, it can be the owner's asset, as long as a bill of sale has been procured that establishes transfer of ownership to the financial institution.

Challenges of Ijaarah Muntahiyah Bittamleek Contract

The risk associated with an Ijaarah Muntahiyah Bittamleek contract is no different than the risk associated with a standard Ijaarah contract, or any other financial contract for that matter. An investor associated with a contract, reaps the fruit of any profit acquired through it or bears the risk of any loss acquired through it; for example:

1. Risk mitigation associated with an Ijaarah Muntahiyah Bittamleek contract, at times, may not appear to be consistent with the risk of investment.
2. Credit enhancement may appear difficult, and downright impossible, at times.
3. Supply risk – risk associated with the delivery of the asset in the exact manner stipulated in the contract – is beyond the customer's control.
4. If the agency of purchase is within the hands of the customer, it might give rise to suspicion or conflict of interest for the lessor and/or price manipulation by the lessee.
5. If the lessee declines to purchase the asset at the end of the lease contract, the lessor might be left stranded with an asset at a market price less than the original, purchase price. This can lead to mild to heavy financial losses.
6. The lessor might stipulate that the lease installment payment will increase after a portion of the rental period has passed.
7. Lastly, well-known issues like insufficient takaaful to cover the any mishaps during the rental period or non-compliance with Shariah principles in terms of asset

usage/operation are always present and can easily creep into the contract.

Conclusion

Since the subject of a rental agreement is the usufruct and not the asset itself, it is the responsibility of the lessee to preserve and maintain the asset (not necessarily financially), for the asset does not belong to him (yet). Moreover, the basis for the condition that an Ijaarah Muntahiyyah Bittamleek contract is beneficial is that leasing an asset that will be used for activities not sanctioned by the Shariah, with the knowledge and permission of the lessor, qualifies the lessor a guilty party in said activities. Remember, Allah the Almighty has said in Surah al-Maidah, verse 2, **“Help you one another in righteousness and piety.**

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Merit Research Journal of Accounting, Auditing, Economics and Finance Vol. 2(1) pp. 1

