

Legality of Tawarruq in Islamic Finance

Nur Yuhanis Bt Ismon

Jalan Baiduri 2 No.1, Taman Baiduri, 43800 Dengkil, Selangor, Malaysia, annyss0306@gmail.com

Abstract

Objective – Islamic finance has been established as an alternative to the conventional banking system which is made up component not permitted under *Shariah*. *Tawarruq* is one of the Islamic finance products which commonly used in Islamic banks. This research assesses two important areas which include the principle of *Tawarruq* in *Fiqh* perspective and the practical aspect of such principle in Islamic banks in Malaysia.

Method – The method used for this research is comparative analysis.

Result – This research begins to explore the different views of the proponent and opponents toward the legality of *Tawarruq* in *Fiqh*. Instead of considering the basic condition of the valid sale, the other aspect has to be pondered by the contemporary scholars to render *Tawarruq* is valid sale according to *Shariah*. The legality of *Tawarruq* has been debate by some scholars. Due to that, there are different resolution and rulings from Islamic countries on legality of of *Tawarruq*. In the practical aspect, *Tawarruq* has been used in Malaysia by Bursa Malaysia *Suq Al Sila'* as a trading platform and it uses Crude Palm Oil (CPO) as the commodity in *Tawarruq* transaction. While, in the Middle East, it uses London Metal Exchange (LME) in dealing with commodity transaction through *Tawarruq* principle.

Conclusion – Based on the legal argument on the permissibility of *Tawarruq*, it can be summarized that *Tawarruq* is permissible but subject to certain condition. Provided that genuine *Tawarruq* is permissible than organized *Tawarruq* in *Tawarruq* transaction.

Keywords : Tawarruq, Murabahah

Abstrak

Tujuan - Keuangan Islam telah ditetapkan sebagai alternatif sistem perbankan konvensional yang karena memiliki komponen yang tidak diperkenankan dalam Syariah. *Tawarruq* adalah salah satu produk keuangan Islam yang biasanya digunakan di bank syariah. Kajian ini menilai dua aspek penting yang meliputi prinsip *Tawarruq* dalam perspektif Fiqh dan aspek praktikal seperti yang dilaksanakan di bank-bank Islam dalam konteks Malaysia.

Metode - Metode yang digunakan untuk kajian ini adalah analisis perbandingan.

Hasil - Kajian ini bermula untuk mengeksplorasi pandangan yang berbeda dari pendukung dan penentang terhadap legalitas *Tawarruq* dalam perspektif Fiqh. Selain mempertimbangkan asas penjualan yang sah, aspek lain perlu dipertimbangkan oleh ulama kontemporar adalah untuk menjadikan *Tawarruq* sebagai penjualan yang sah menurut Syariah. Legalitas/Kesahihan *Tawarruq* telah menjadi perdebatan para ulama. Oleh itu, terdapat resolusi yang berbeda dan hukum dari negara-negara Islam pada legalitas/kesahihan *Tawarruq*. Dalam aspek praktikal, *Tawarruq* telah digunakan di Malaysia oleh Bursa Malaysia *Suq Al Sila'* sebagai platform perdagangan dan menggunakan Minyak Sawit Mentah (MSM) sebagai komoditi dalam transaksi *Tawarruq*. Sementara itu, di Timur Tengah, ia menggunakan Bursa Logam London (LME) dalam menangani transaksi komoditas melalui prinsip *Tawarruq*.

Kesimpulan - Berdasarkan argument/hujjah hokum/undang-undang diperbolehkannya *Tawarruq*, dapat disimpulkan bahwa *Tawarruq* diizinkan tetapi tunduk pada kondisi tertentu. Dengan syarat yang dibenarkan dalam transaksi *Tawarruq* adalah *Tawarruq* yang asli bukan *Tawarruq* yang terorganisir

Kata Kunci : Tawarruq, Murabahah

1. Introduction

In the context of *Shariah*, there are permissible and non-permissible attributes as to how Muslims conduct their activities and it includes economic participation, which must be free of forbidden elements among others as *Riba'*, *Gharar* and *Maisir*. Islamic finance involves the provision of financial product and services which Islamic banks offer to the customer.²⁵

Tawarruq is one of the Islamic finance product as to deposit financing, liquidity financing and personal financing. Those types of Islamic financing used *Murabahah* and *Tawarruq* as a product in the particular transaction. In Malaysia, the operation of *Tawarruq* is supervised by *Shariah* Committee (SC) in addition to the advice of the *Shariah* Advisory Council (SAC) which is the highest *Shariah* body set up at Bank Negara Malaysia (BNM) can be sought to ensure uniformity in views and practices.

Nowadays, Islamic banks found the new Islamic finance product derived from *Murabahah* financing which known as *Tawarruq*. The concept of *Tawarruq* or commodity *Murabahah* has been widely applied in Islamic finance (Zukri, 2009). In Malaysia, it was officially endorsed as a permissible instrument to be used in financial market especially for personal financing by the *Shariah* Advisory Council of Bank Negara Malaysia (BNM) on 28 July 2005 (Dusuki, 2007).

Tawarruq is the types of transaction where a person buys a commodity with a deferred payment then sells it to a third party other than the original seller for an immediate cash price. It is generally used to describe a transaction in which a Islamic bank sells a commodity to a customer on deferred payment at cost plus profit, and the customer then sells the commodity on a spot basis to a third party for cash²⁶. The purpose of this contract is to obtain cash immediately from another party (Zuhaily, 2007).

²⁵ Ahmad Tajudin, Azrul Azwar. 13 Disember 2010. "Overview of Islamic Finance". Islamic Finance Course: Structure and Instrument. (Article) <http://www.bankislam.com.my>

²⁶ Hassan, Zulkifli. 2009. "*Tawarruq*: A Methodological Issue in *Shariah* Compliant Finance". <http://zulkiflihasan.wordpress.com>

Nevertheless, the validity of the application of *Tawarruq* in Islamic banking is questionable either it is permissible or not. The resistance still exist on the ground from some critics who say that *Tawarruq* based financial product bear a striking resemblance to interest based product. For instance, the *Islamic Fiqh Academy of Rabbithah 'Alam Islami*, Mecca ruled in 2003 that any product structure based on *Tawarruq* concept should be considered as *Haram*, or forbidden in Islamic law.

Thus, this research is viable and necessary to analyze the comparative views from the different Islamic scholars and the implications on the practical aspect in Malaysia regarding to the legality of *Tawarruq*.

1.1. Problem statement

Murabahah and *Tawarruq* are the Islamic finance products which are commonly used in Islamic banks. Initially, *Shariah* scholars and majority of *Fuqaha* in classic form endorsed and permit the application of *Tawarruq* as mentioned in *Hanbali* school of thought and its substance under other names is also found in all schools of thought. The position of *Murabahah* also accepted unanimously by all the four schools of Islamic law and the majority of the Muslim jurists. Recently, there are controversial issues on the permissibility of *Tawarruq* whereby some argues that *Tawarruq* is permissible and not violate the established principle of *Shariah* because its application is to refrain from *Riba* and cannot considered as *Hilah* or trick. Nevertheless, some people argued that *Tawarruq* is prohibited because of the harmful effect to the customer itself.

1.2. Research Question

1. What are the basic conditions to render *Tawarruq* valid in Islamic finance?
2. What are the proponent's argument on the legality of *Tawarruq*?
3. What are the opponent's arguments on the legality of *Tawarruq*?
4. How *Tawarruq* is practiced in Malaysia and Middle East countries?

1.3. Scope of the research.

The scope of this research is focusing on comparative study of legality of *Tawarruq* in Islamic financing in different views of scholar and practice of Islamic bank. This research limits to *Fiqh* and legal issues on the permissibility and how they argue on its permissible and impermissible of *Murabahah* and *Tawarruq*. It also focuses on banking practice in Islamic bank or other bank which adopt Islamic window in Malaysia.

2. Methodology

The type of approach of this research is legal research method on comparative approach of the legality of *Tawarruq* based on various view and *Fatwas*. Analytical and critical studies also to be used to the implementation of both products in banking practice.

Besides, qualitative research is required in ascertaining how the people think on the issues of *Tawarruq* concerning their legality in *Shariah* in order to get deeper knowledge of the variety of ways people engage with world around them.

The materials used in this research are largely library-based and it will consist of secondary sources such as books, articles, journal, relevant document, official statistic relating to the application of *Tawarruq*.

3. Result

3.1. *Tawarruq* concept

From the continue developing of *Murabahah* in Islamic banks, the new Islamic product was introduced. *Tawarruq* is derived from the word *wariq* which linguistically means Dirham from silver. Thus, *Tawarruq* means seeking *wariq* i.e. silver dirham, which money or profitable cash. Nevertheless, nowadays the meaning of *Tawarruq* is slightly different as seeking cash immediately. In modern economic terminology, *Tawarruq* is to sell a specific commodity in seeking for liquidity (Yusri and Abdurrahman, no year).

Tawarruq means to purchase a commodity at deferred price, either by negotiation or *Murabahah*, and then sell the commodity to a third party, in order to obtain liquidity. In

this sense, *Tawarruq* is a mutual trade, because there is no difference between buying at cash and selling at cash or deferred price (Alhadad, no year). According to Mohammad Netajullah Siddiqi, in *Tawarruq*, ‘The client i.e. the *Mutawarriq* buys commodity on deferred payment from the International Financial Institution (IFI) and sells commodity for a cash amount less than the deferred price to a third party.

3.2. *Forms of Tawarruq*

Basically the term of *Tawarruq* we can divide into two (Mihajat and Haliding, no year). The first is classical *tawarruq* (*Al-Tawarruq al-Fardi*) and the second is organized *Tawarruq* (*Al-Tawarruq al Munazzam*). Classical *Tawarruq* is defined as the purchase of a commodity possessed owned by the seller for a delayed payment, whereupon the buyer resell the commodity for cash to other than the original seller in order to acquire cash (*Al-Wariq*). The contemporary definition on organized *Tawarruq* is the transaction that a person (*Mustauriq*) buys commodity from local or international market at a deferred price. Simultaneously, he (*Mustauriq*) will ask the financier in his own capacity or through his agent or by special agreement with *Mustauriq* to rearrange the sale transaction usually at a lower spot price.

3.3. *The Proponent’s Arguments on Tawarruq*

3.3.1. *Tawarruq is a type of sales*

Tawarruq defined as buying commodity with deferred payment and selling it to other than the seller in order to obtain cash. It is generally acceptable by referring to verses in Al Quran when Allah says, “*Allah has allowed trade and has prohibited Riba*” (Al Baqarah 2:275). In addition, Islam does not prohibit any trade except those which involve injustice, cheating, making exorbitant profits, or the promotion of something which is *Haram* (Al Qaradawi, no year). It denotes that the word trade is the generality of all types of trade and permits every sale, where *Tawarruq* is like any other sale.

3.3.2. *Mutual consent between the parties*

Every agreement made between the parties is legally permissible in Islam when if both parties agreed and have mutual consent toward their agreement or transaction. This principle was laid down in Al Qur'an: *'O you who believe! Do not squander your wealth among yourselves in vanity, except it be a trade by mutual consent'* (An Nisa' 4 : 29). Thus, the free agreement is one of the conditions which render the transaction valid in Islamic point of view especially in debt transaction. *Tawarruq* is based on mutual consent between the customer and Islamic banks.

3.3.3. *No harmful effect*

It was narrated that Ibn Mas'ud ruled that there was no harm in declared lump sum or percentage profit margins. In this regard, the cost in *Tawarruq* is determined and thus permitted.

3.3.4. *No element of Riba'*

Allah said, *"O ye who believe! Squander not your wealth among yourselves in vanity, except it be a trade by mutual consent"* (An Nisa' 4 : 29). This verse shows that it is prohibited to eat the property of others by using the incorrect ways, which are not in line with the *Shariah*, such as *Riba'*, *Qimar*, *Ghisyh*.

Murabahah transaction is not based on *Riba'* because the profit margin agreed by both parties and there is no other hidden payment charged by the seller to the purchaser. Nevertheless, some argues that what are the differences between profit margin in *Murabahah* and interest charged by conventional bank through the loan given. The argument is that the profit margin offered in *Murabahah* transaction determined by negotiation by both parties i.e. between the bank and the customer until they mutually agreed into the transaction. While in conventional bank, the interest determined by keeping up with interest rate developed in financial market (Khalid, no year).

In case of default payment occurred, the client of credit loan will be penalties, in contrary the client of *Murabahah* financing disallowed to be penalties. The price in the

beginning of *Murabahah* contract is the final price fixed until the end of installment payment finished. Thus, there is no other penalty in the case of default of payment

It same goes to *Tawarruq* where the trade is like selling the commodity to the purchaser at a high price through debt, and the buyer sell the commodity at a lower price to the third party at the same price, in order to make the profit differ from the other price. This type of sale is permissible i.e. *Tawarruq*, because there is no *Riba'*.

3.3.5. *Tawarruq as to avoid usury without Hilah*

The scholars who permit *Tawarruq* based on the Hadith of Bukhari Muslim²⁷, who has been proven to support the *Tawarruq* transaction, on the occasion when a farmer from *Khaybar* came to the Prophet Muhammad, bearing dates of the highest quality. The Prophet asked him, “Are all the dates from *Khaybar* of good quality?” and the farmer answered, “No, I have exchanged two kilograms of low quality dates for one kilograms of superior quality.” On hearing the farmer’s answer, the Prophet Muhammad forbid this, and recommended he sell all his low quality dates for cash, to obtain money, then to buy dates of a superior quality (Hosen and Narawi, 2009).

This *Hadith* indicates the legal trading method to avoid usury, without the existence of *Hilah* or anything of that nature, because trading conditions had been fulfilled and there was no usury in this trade transaction.

Ibn Baaz said with regard to the issue of *Tawarruq*, it is not *Riba'* and the correct view is that it is permissible, because of the general meaning of the evidence and because it facilitates relief and enables people to meet their current needs. As for the one who sells it to the one from whom he bought it, this is not permissible rather this is a *Riba'*-based transaction, which is called *Innah*. This is *Haram* because it is a trick aimed at getting around the prohibition on *Riba'* (Yusri and Abdurrahman, no year).

Thus this matter indicates the legality of trading transactions, wherein the intent and differing goals using a medium is acceptable and may be carried out, or put into

²⁷ Hadith. Sahih Bukhari and Muslim. Book 34 : Sale and Trade. Hadith 405 (volume 3)

practice, as well as being free from usury explicitly or implicitly. In other words, the *Tawarruq* transaction is permitted and is made legal when it is indeed required

3.4. *Actual possession of the commodity*

Moreover, for this sale to be acceptable, the purchaser should fully possess the commodity before selling them for the second time. It means, the sale should be separate from the first sale. This conditions are based on evidence from Abdullah Ibn Umar narrated that the Prophet Muhammad prohibited selling the goods unless one has fully taken possession of it beforehand.(Abu Dawood)

The Prophet Muhammad said: “It is prohibited to give loan with a condition that the debtor buys goods from the lender; two condition in one sale i.e. having two prices one in cash payment and another in the delayed payment are also prohibited, and one is not permitted to benefit from any goods unless it becomes fully in his possession and he can guarantee, and one is not permitted to sell what he does not own”(At Tirmizi)

Imam Muslim also reported that the Prophet Muhammad forbade selling food grain until it fully becomes in one’s possession. In *Murabahah*, the actual possession was existed when the developer firstly transfer the ownership to the banks before the bank sell it to the customer. While in *Tawarruq* sale even though there is two condition in one sale but party will be firstly possess the asset before selling to other party in cash basis.²⁸

3.5. *Legal maxim of all useful things is permissible and the original rule about all harmful things is prohibition*

Concerning to the legal maxim as states, “The original rule about all things is permissibility”. Wahbah Zuhaily says that this legal maxim is appropriate for things where there is no evidence on its prohibition. However, there is a legal maxim that clears the previous maxim, which is, “The original rule about all useful things is permissibility and the original rule about all harmful things is prohibition (Zuhaily, no year). Based on

²⁸ Hadith. Sahih Muslim. Book 10: Kitab Al Buyu’

the legal maxim, *Tawarruq* is useful to provide liquidity to those who needs money immediately.

Additionally, the original ruling for any transaction is permissible, unless there is evidence that forbids the transaction, and there is no better proof of legal evidence that prohibits *Tawarruq* transactions. Thus, transaction of *Tawarruq* is legally permissible in Islam.

3.6. Hanbali jurist on *Tawarruq*

Tawarruq is mentioned explicitly only by the *Hanbali* jurists, the majority of whom deem it permissible. With respect to the other three schools, although the name of the sale is not explicitly mentioned in their legal texts, it can be deduced from inference that it is permissible. Some jurists such as Ibn Humam of the *Hanafi* School still viewed lending money without interest as more preferable.²⁹

3.7. Fatwas from Islamic countries on *Tawarruq*

ORGANIZATION	RULLINGS
1. Islamic <i>Fiqh</i> Academy, whose membership consist of Islamic countries assembled in the 15 th Annual Session of the Organization of the Islamic Conference	Issued a resolution supporting <i>Tawarruq</i> , on one condition, that the purchaser, or <i>Mutawarriq</i> , does not resell the item he has bought to the original seller at a lower price, either directly or indirectly. If or when this condition is not adhered to, the <i>Tawarruq</i> transaction is categorized as usurious, which is forbidden (Hosen and Narawi, 2012).
2. Islamic Judicial Assembly, a branch of the World Muslim League during its Conference of Rajab, 1419H	Decided the permissibility of <i>Tawarruq</i> . ³⁰
3. Accounting and Auditing Organization for Islamic Finance (AAOIFI)	Issued <i>Shariah</i> standard on the application of <i>Tawarruq</i> on Standard No.3. The procedure is when two contracts will be executed. First contract involves the purchasing of commodity on deferred which call as <i>Murabahah</i> or <i>Musawamah</i> . Second contract involves the selling of the commodity to third party on cash basis which was stated in Standard No 30 (2).
4. <i>Fatwass</i> Permanent Committee for Scientific Research	The issue of <i>Tawarruq</i> is mentioned in it as, “When someone buys a commodity on credit, so that he can sell it in the market to the non-debtor, which he can benefit from its amount, if the debt becomes payable, it will be paid to its owner who bought it on credit. The sale by installment is allowed, the saying that it is disallowed should not be considered, due to the
5. <i>Shariah</i> Advisory Council of Bank Negara	Resolved that deposit product and financing based

²⁹ A. Khan, Faraz. 26 January 2012. “The Ruling of Using Alternative Financing Mechanism”. (<http://seekersguidance.org/ans-blog/2012/01/26/the-rulings-of-using-certain-alternative-financing-mechanisms/>)

³⁰ Muhammad Ayub. “*Tawarruq*”. (Research Paper). <http://islamicstudies.islammesssage.com/ResearchPaper.aspx?aid=429>

Malaysia in its 51 st meeting held on 28 th July 2005	on the concept of <i>Tawarruq</i> is known as commodity <i>Murabahah</i> is permissible. The standard agreement for <i>Tawarruq</i> deposit accounts also was launched between banks and corporate which aim to remove the barrier to the sector's growth.
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From the above table, the permissibility of *Tawarruq* has been recognized by the organization but it subject to the certain condition or requirement to render such transaction is valid according to *Shariah*.

3.8. The Opponent's argument on *Tawarruq*

The issue of *Tawarruq* is controversial in deciding the legality as many scholars have different views whether *Tawarruq* is permissible or not. Some scholars permit *Tawarruq* to be practiced in Islamic banking and some scholars prohibit the application of *Tawarruq* because of some factors.

3.8.1. *Illah of Riba'*

Ibn Taymiyyah from *Hanbali* School and his student, Ibn Alqiyam chose to prohibit *Tawarruq*. In his book, *A'lam Almuq'in*, Ibn Alqiyam said, "My sheikh i.e. Ibn Taymiyyah prohibited *Tawarruq*, and people asked him again to allow it, but he still prohibited *Tawarruq*. Furthermore, he added that the '*illah of Riba'* is achieved in *Tawarruq*. However, *Tawarruq* is worse than *Riba'*, because *Tawarruq* entails a higher cost and losses (Alhadad, no year).

There is a tradition that disapproves *Tawarruq*. The tradition was narrated from Umar, that he disapproved *Tawarruq* and he said, "*Tawarruq* is the origin of *Riba'*". He means that *Tawarruq* contains a trick that leads to lending money with interest, as practiced in some types of *Riba'*, such as *Riba' Anasiyah*.

3.8.2. *Tawarruq as a sale of forced person*

Imam Ahmad justified the opinion of disapproving by saying that this is the sale of a forced person as Abu Dawood narrated from Ali that the Prophet Muhammad did not allow the sale of a forced person.

3.8.3. *Tawarruq transaction same with Inah which was prohibited by many scholars*

According to the *Malikis*, *Tawarruq* is impermissible and their evidence is based on what Ahmad said in “*Az-zuhdi*”, narrated from Ibn Umar, “There is a time that comes toward us and we find that none of us says that he has the right of Dinar and Dirham from his Muslim brother. Then, he said, “I heard the Prophet Muhammad said, “If people practice *Inah*, then they follow the tails of cows and leave jihad in the way of Allah and Allah will punish them and not forgive them until they come back to their religion.”³¹

3.8.4. *The objective of buying and selling does not exist in Tawarruq*

Everything is recognized with its objective and not with its sayings and the exact expenditure is only recognized with regard to its objective. The Prophet Muhammad said, “The reward of deeds depends upon the intentions and every person will get the reward according to what he has intended.” The purpose of this transaction is to obtain money, instead of selling and it is the feature of *Riba*’, which is impermissible

3.8.5. *Mafasid overwhelm Masalih*

Moreover, some scholars forbid *Tawarruq* because of *mafasid* overwhelm *masalih*. The calculus of *masalih* and *mafasid* has been an essential tool of Islamic jurisprudence since the earliest days. Among the harmful effect of *Tawarruq* are it leads to creation of debt whose volume is likely to go on increasing, it results in exchange of money now with more money in future, which is unfair in view of the risk and uncertainty involved and it leads, through debt proliferation, to gambling like speculation³². It is the cause for *Tawarruq* to be impermissible in Islamic banking system.

3.9. *The practical aspect of Tawarruq*

Based on the permissibility of *Tawarruq* by some scholar, Islamic banks started using it as friendly product to their customer to facilitate in obtaining the cash against a higher value of cash on deferred payment basis by adopting a series of purchase and sale

³¹ Khayat, Abdul Aziz. “*Tawarruq*, Its concepts, Its Practices and Its Economics Implication on Its Promotion by Islamic Banks”. p 3 ([http://www.kantakji.com/Fiqh/Files/Markets/a%20\(70\).pdf](http://www.kantakji.com/Fiqh/Files/Markets/a%20(70).pdf))

³² Siddiq, Mohamad Nejatullah. “Economics of *Tawarruq*”. p 6 (<http://www.iefpedia.com/english/?p=765>)

contracts. *Tawarruq*'s purpose is to provide cash immediately, the idea behind deriving such opinion was the concern that Islamic banking has no alternative to advance cash to the customers, ignoring the fact that Islamic banks are the institutions which are investors and not the financial intermediaries or cash providers.³³

3.9. *Tawarruq Product*

The Islamic financial system comprises four main components, namely Islamic banking, Takaful, Islamic interbank money market and Islamic capital market. Basic elements of Islamic finance include profit and risk sharing, transparency and full disclosure, good governance, value-based innovation and principles of justice. These collectively provide implicit checks and balances in the system.

Islamic banking in Malaysia has become a substantial and fastest growing industry during the last four decades. It has followed the Islamic transactions rules and principles of *Shariah* to carry out their business (Henry and Wilson, 2004). In accordance to *Shariah* principle, any payment or receipt of interest is strictly prohibited even though the product and service offered by Islamic banks is more or less similar to conventional bank but the transaction must be accordance to the principle underlying by *Shariah*. The transaction includes the deposit, financing and also liquidity. Those types of transaction are mostly used by Islamic banks according to the need of the customer.

Deposit is simply means when the customer intent to deposit their money to the bank. Deposits in Islamic banks are usually based on principle of profit and loss..If something happens and the bank suffers loss it has to be transferred to the depositor directly.³⁴ It means that the banks act as an agent to purchase the metal commodity on behalf of the customer will receives cash from the customer, for the price of the commodity, which is deemed as deposit in the bank's account

³³ Hussien Hamed, Hassan. "Institutional *Tawarruq*. A Prohibited Practice". (Translation). (<http://www.hussein-hamed.com/pagedetails.aspx?id=115>)

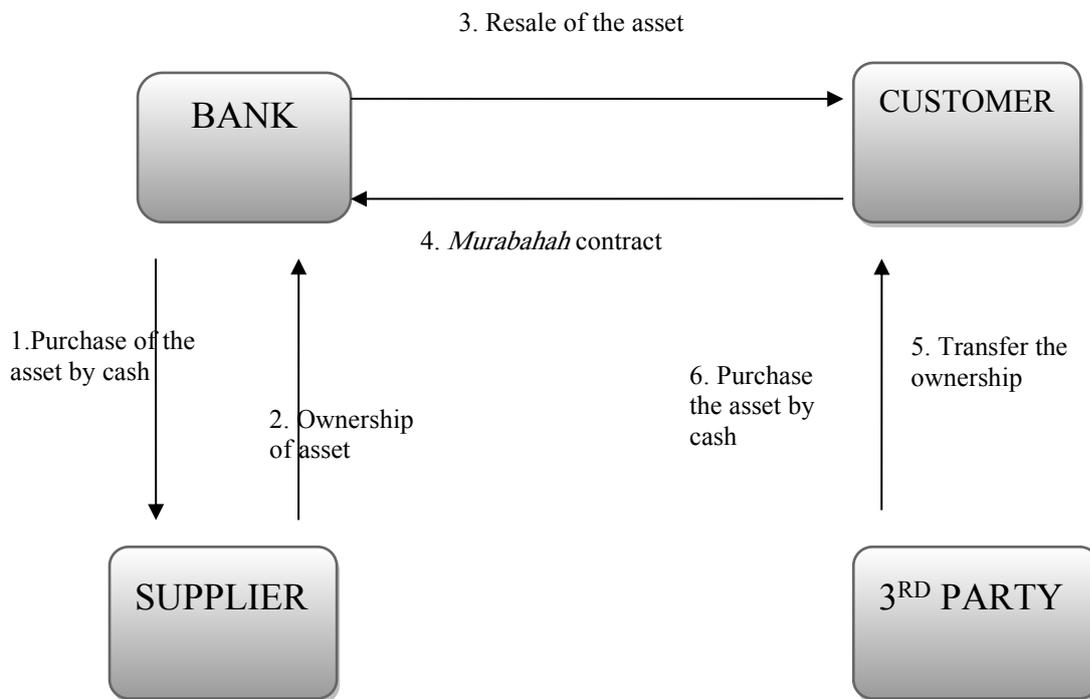
³⁴ Karimi, Abdul Jabar. "Challenge Facing Islamic banks". (<http://www.nzibo.com/IB2/Challenges.pdf>)

While financing and liquidity means the cash sale price by the customer to the metal trader A enables the customer to obtain cash for financing, the deferred sale price from the bank to the customer enables the customer to pay back the financing facility to the bank, within an agreed term.³⁵

In conjunction with this, there has also been a growing range of products and services being offered by Islamic bank. These products have become competitive both in terms of product structure and pricing. *Tawarruq* is one of the Islamic financial products which was recognized in most Islamic banks in Malaysia.

In *Tawarruq* concept, there are four parties involved which are the customer, the bank, and the two brokers. There are two transaction involved in *Tawarruq* which are *Murabahah* and *Wakalah* contract. The modus operation of *Tawarruq* financing is illustrated in Figure 2.

Figure 2 : *Tawarruq* financing



Source : Book of Islamic Banking: A Practical Perspective by Kamal Khir

³⁵ N.a. “Deposit and Financing Product Based On *Tawarruq*” (<http://www.isra.my/Fatwass/topics/treasury/interbank/Tawarruq/item/260-deposit-and-financing-products-based-on-Tawarruq.html>)

The description of *Tawarruq* financing is as following step :

1. The bank purchase the asset from the supplier by cash payment at the priced sale
2. The supplier transferred the ownership of the asset to the bank
3. The bank then resell the asset to the customer
4. The customer pay the asset with deferred payment i.e. the price sale plus the profit margin agreed by both parties
5. At the same time, the customer sell the asset to third party
6. The third party purchases the asset by cash payment.

3.9.1. The Practice of *Tawarruq* in Malaysia

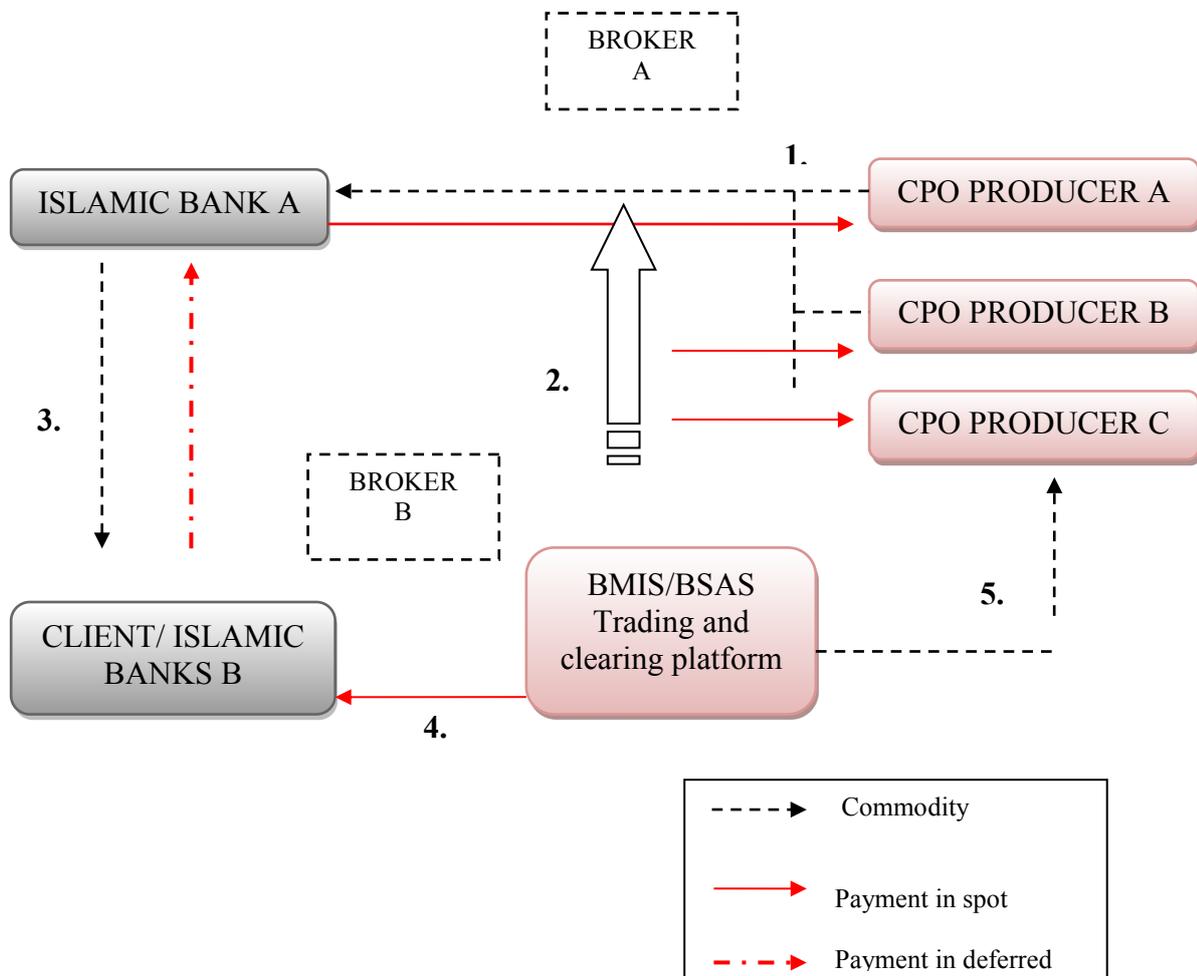
Shariah Advisory Council in Malaysia on 51st meeting held on 28th July 2005 resolved that deposit product and financing based on the concept of *Tawarruq* is known as commodity *Murabahah* is permissible. The standard agreement for *Tawarruq* deposit accounts also was launched between banks and corporate which aim to remove the barrier to the sector's growth. This enables the Islamic banks to create financing transactions that involve specific assets, fulfilling Islam's demand that all deals must involve real economic activity.³⁶ Commodity *Murabahah* and some forms of *Tawarruq* have drawn criticism from several clerics who say the structures fall foul of Islamic principles. Some Malaysian Bankers believe *Tawarruq* deals can be a sham with no true sale taking place and no real transfer of risk to the buyer of the goods. This shows that the *Murabahah* version of Malaysian is yet matured and needs more attention by *Shariah* Scholars.

Regarding *Tawarruq*, Bursa Malaysia introduced the Commodity *Murabahah* House which known as *Suq al-Sila* ' as a platform to assist Islamic financial transactions. Bursa Malaysia introduced Bursa Malaysia *Suq Al-Sila* ' (BSAS) in 2009 a purposefully designed exchange-traded platform to facilitate *Tawarruq* transactions, particularly for Islamic banks, while addressing the scholars' concerns about violations in the existing

³⁶ n.a. 20 August 2009." Malaysia Launched Standardized *Murabahah* Deposit". (<http://www.reuters.com/article/2009/08/20/malaysia-islamic-financial-idUSKLR51439020090820>)

practice of organized *Tawarruq* using various international commodity platforms. In particular, it offers solutions to transact *Tawarruq* based on a real commodity market. This platform is claimed to provide genuine commodity transactions where possession and delivery of the commodity can take place without any hindrance, as opposed to the controversial practice of *Tawarruq* using a platform like the London Metal Exchange (LME). In Malaysia, at the outset, BSAS will start out by trading in local crude palm oil (CPO) but move on to other *Shariah*-approved commodities including cars, air conditioning units, oil, copper and aluminum. The process and mechanism used in the Bursa Malaysia *Suq Al-Sila'* (BSAS) is illustrated in Figure 3.

Figure 3 : Mechanism used in the Bursa Malaysia *Suq Al-Sila'*



Source : Article of *Fiqh* Issue And Operational Problem In Contemporary Product: Special Focus On Commodity Transaction by Adnan Hasan, IIUM, Malaysia

Illustration and discussion of Bursa *Suq al-Sila'* (BSAS) based on Figure 3 as follows:

1. Before the market opens, bids by banks and offers by CPO suppliers are lined up; orders will be randomized upon market opening. When the market opens at 10.30 am, trade starts with order matching by the BSAS engine. The CPO Supplier sells the commodity straight to an Islamic Bank (via Broker A).
2. Bursa Malaysia Islamic Services (BMIS) ensures the performance (delivery) of CPO suppliers, in order to avoid strict Know-Your-Customer (KYC) appraisal by Islamic banks. At this stage, trade confirmation is sent to all parties. Islamic Bank A pays the price by crediting the BMIS account.
3. Islamic Bank A sells the commodity to its client or another Islamic bank by a deferred *Murabahah* contract. Trade is reported to BSAS for change of ownership in depository.
4. Client or Islamic Bank B sells the commodity to BMIS via an agent of Islamic Bank A or directly (may use Broker B). BMIS pays party B by instructing Islamic Bank A to debit its account in favor of B. Commodity ownership transfers to BMIS.
5. Sale by BMIS to CPO supplier is on a random basis, and matching is based on bids by suppliers replicating the real market. Once ownership is back to a supplier, all unencumbered commodities may or may not be re-offered into the BSAS market for other trades. Last purchase order: 5.30 pm; market closes at 6.00 pm.

An example of the current utilization of *Tawarruq* is as offered by HSBC Amanah's Personal Finance, where the customer buys metals from the bank at a pre-agreed profit margin which sum is payable in installments, and then sells the metals on the customer's behalf to an international broker. Bank Muamalat Malaysia Berhad also utilises *Tawarruq* in its Muamalat Cash-Line Facility-i, which is offered for working capital purposes.

In a nutshell, *Tawarruq* is an Islamic Finance product as commonly used in deposit, financing and also liquidity transaction in most Islamic banks. The rules related to the application and operation of *Tawarruq* are governed by *Shariah* Advisory Council of Bank Negara Malaysia (BNM) and supervised by *Shariah* Committee for the purpose of standardization and harmonization. Moreover, Bursa Malaysia *Suq Al Silaq* has been established as a platform to assist Islamic financial transactions through *Tawarruq* concept and used Crude Palm Oil (CPO) as a commodity in the transaction. While in the Middle East, they used London Metal Exchange (LME) in their commodity transaction.

3.10. Analysis Towards the Application Of Tawarruq Practice

Tawarruq is an Islamic finance product introduced by Islamic banks after its permissible has been affirmed by *Fatwas* and resolution from the Islamic countries. Basic condition of valid sale in *Shariah* shall be met before it can be concluded as a valid sale. However the conditions are subject to some limitation according to contemporary scholars when they argue on another aspect of *Tawarruq* to be valid.

Besides that, even though there are regulation and legal framework which govern the operation of *Tawarruq* but monitoring and controlling such operation shall be maintained by Islamic banks to ensure that Islamic finance product operated according to *Shariah*.

The used of *Tawarruq* in Gulf Cooperation Countries (GCC)As compared to the practice of *Tawarruq* or Commodity Murabahah in GCC the application was rapidly growth rather than Bai Al Innah due to the resolution passed by the organization such as AAOFI and Fiqh Academy. The resolution permits *Tawarruq* to be implemented in Islamic banks but subject to certain requirement and condition.

3.11. Analysis on the Shariah Position of Murabahah and Tawarruq

In *Shariah*, sale means exchanging of a thing of value with another thing of value by mutual consent in addition to the sale of commodity in exchange of cash. Basic

condition of valid sale in *Shariah* shall be met before it can be concluded as a valid sale. The conditions of valid sale outlined by *Shariah* are strictly applied before the sale or transaction has taken places. The condition are as follows :

3.11.1. The parties involved must be qualified and mutually consent to enter into contract

In Islam, every transaction of sale and purchase shall exists the offer and acceptance i.e. *Ijab* and *Qabul* to make the transaction is valid according to *Shariah*. In particular transaction, it is permissible to purchase on credit by mutual consent.

The Prophet Muhammad bought some grain from a Jew, to be paid for at specific time, pledging his coat of mail as security³⁷. Based on this *Hadith*, a group of jurists are of the opinion that, should the seller increase his price if the purchaser asks for deferred payments, as is common in installment buying, the price differential due to the time delay resembles interest, which is likewise a price for time; accordingly, they declare such sales to be *Haram*.

3.11.2. Subject matter or sold good.

The subject of sale must be exist at the time of sale and must be in the ownership of the seller at that time. Hence, what is not owned by the seller cannot be sold to the purchaser. The existing subject matter is very vital to ensure that there is no defect or uncertainty toward the sold good. The rationale of this element is to maintain the relationship between the purchaser and seller in the transaction regardless of taking risk to accept the goods which are not existed at the time of sale

Besides that, the subject of the sale must be in the actual or constructive possession of the seller at the time of sale. Constructive means that the purchaser has not taken actual delivery of the goods, but the ownership risk of the goods has been

³⁷ Hadith : Reported by Al Bukhari

transferred to him. It means the good are under the purchaser control and all rights and liabilities of the goods have passed on him (Ayub, no year).

The sale must be instant and absolute. Thus a sale attributed to a future date or a sale contingent on a future event is void. The basic rule of valid sale is strictly applied to every transaction but it subject to certain exception which render the sale is valid i.e. sale on deferred payment. Al-Shawkani says, "On the basic of legal reasons, the followers of *Shafi'i* and *Hanafi* schools, *Zaid bin 'Ali*, al *Muayyid Billah*, and the majority of scholars consider the sale of deferred payment is lawful." Al-Shawkani said, "We have compiled a treatise on this subject and have called it '*Shifa al'ilal fi hukum ziyadat al-thamam li mujarradal-ajal*' which means the reason for increasing the price due to lapse of time (Ayub, no year).

The subject of sale should be an object of value. A thing has no value according to the usage of trade cannot be sold in addition to should not be a thing used for Haram purpose. The subject should be *Maal-e- Mutaqawwam*.

The subject of the sale must be identified and specifically known to the purchaser by pointing out or by detailed specification which can distinguish it from other thing not sold. Uncertainty of the subject of the sale will render the transaction invalid and the element of *Gharar* or uncertainty is strictly prohibited in Islam.

3.11.3. The delivery of the goods and the transfer of the ownership of the good

The sale of goods means the definite transfer of ownership of goods to the purchaser against the payment of a price that can be on the spot, delayed i.e. sale of credit, or in advance. The risk and reward to the sold good

The customer can buy the goods after ownership has transferred and possession has taken place, i.e. after the contract with the importer of the goods has been concluded and there is confirmation of the receipt of goods from the importer, as confirmation has the rule of actual possession. The rationale is selling something before possession takes

place can lead to **disputes**, especially if the goods are found to be defective. Alternatively, if actual possession is not possible, and then **constructive possession** would suffice, i.e. based on clearing and confirmation.³⁸

3.11.4. Price or *Dhaman*

In term of price and the cost involved in *Murabahah* and *Tawarruq* transaction, the seller must state the original price and the additional expenses incurred on the sale item and he must just and true in his word. The additional expenses incurred such as transport, processing and packaging charges that enhance the value of the commodity in any way and that are added as a custom by the merchant community in the original price can be added into the purchase price to form the basis of *Murabahah* (Ayub, no year).

Other than that, the margin profit on the purchase price so reached has to be mutually agreed upon between the purchaser and seller. The price once fixed as per agreement and deferred cannot be further increase except for rebate received from the supplier. Any unspecified price cannot become a basis of *Murabahah* as it involves the semblance of uncertainty which render *Murabahah* transaction unlawful (Ayub, no year).

However, the majority of scholars permit it because the basic principle is the permissibility of things, and no clear text exists prohibiting such a transaction. Furthermore, there is, on the whole, no resemblance to interest in such a transaction, since the seller is free to increase the price as he deems proper, as long as it is not to the extent of blatant exploitation or clear injustice, in which case it is *Haram*.

The basic condition above has been outlined by *Shariah* in every transaction of sale included *Tawarruq*. Those conditions were fulfilled in *Tawarruq* transaction but the contemporary scholar has their own view on its permissibility when they argued based on another aspect.

³⁸ n.a. “*Murabahah Mudawwarah: Actual or Constructive Possession*” <http://www.isra.my/Fatwas/topics/commercial-banking/financing/Murabahah/item/304-Murabahah-mudawwarah-actual-or-constructive-possession.html>

It also same with *Tawarruq* transaction where even though the basic condition has been established in its application but the permissibility is restricted especially for commercial activities. Another aspect shall be take into consideration in order to ensure that the transaction is in the line of *Shariah*.

3.12. Analysis on the *Tawarruq* practice in Malaysia

Malaysia based on a ruling by the *Shariah* Advisory Council (SAC) of the Central Bank, it is in fact a globally acceptable *Shariah* compliant structure in particular in the Gulf Cooperation Council (GCC) region, sanctioned by Bahrain- based Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI) with the requirement

3.12.1. *Shariah* position

Bank Negara Malaysia (BNM) by *Shariah* Advisory Council at its 51st meeting on the 28th July 2005 resolved that as a deposit product and financing based on the concept of *Tawarruq*, which is known as Commodity *Murabahah*, is permissible. Currently, Malaysia is endeavoring to find a way to adopt the scheme of *Tawarruq* as a liquidity management tool for Islamic interbank overnight and short-term deposits under the brand “Commodity *Murabaha* Program” (CMP) (Nagaoke, no year).

In the Middle East, some Islamic banks set commodity trading contracts i.e. *Murabahah* based on the London Metals Exchange (LME) to manage their liquidity over the years. In 2007, Malaysia created and released its own version of commodity trading *Murabahah*. It was done by issuing monetary notes of BNM backed by the country’s rich crude palm oil (CPO) resources.³⁹

Therefore, *Murabahah* and *Tawrruq* practice in Malaysia differed from practice in Middle East in terms of the commodity used i.e. London Metal Exchange (LME) for

³⁹ Zandi, Gholamreza and Mohd Ariffin, Noraini. “Some Issue On *Murabahah* N Iran And Malaysian Islamic Banks”. (Research). IIUM, Malaysa.(<http://irep.iium.edu.my/>). p 13

Middle East and Crude Palm Oil (CPO) for Malaysian practice by trading platform of Bursa Malaysia *Suq Al Sila*.

3.12.2. Product

The *Shariah* Advisory Council, Bank Negara Malaysia (BNM) also resolved in 2006 that the use of *ijarah sukuk* and Shari'ah-compliant securities as underlying assets in *Tawarruq* or *Murabahah* to manage liquidity in the Islamic financial system is permissible.

Tawarruq has become increasingly popular in Saudi Arabia, UAE, and other GCC (Gulf Cooperation Council) countries in recent years (Hassan, 2012). The National Commercial Bank (NCB) in Saudi Arabia is a pioneer in using *Tawarruq* as a financial product under the brand of *Taysir* in 2000. After this launch, several Islamic banks in the Gulf countries began to adopt *Tawarruq*, and presently, it is a very popular financial product for consumer loans (Shinsuke, no year).

In Arab Saudi, Abu Dhabi Islamic Bank (ADIB) launched an innovative new *Shariah*-compliant financing product called *Al Khair*, based on the Islamic concept known as *Tawarruq*, which is approved by *Fatwass* and the *Shariah* Supervisory Board. *Al Khair* Financing operates on the bases of an Islamic concept known as *Tawarruq* that was approved by the Islamic *Fiqh* Academy. *Tawarruq* transaction is used in *Al Khair* Financing and implements the following, specified steps:

1. The bank purchases a commodity equivalent to the amount of customer's financial liability and conventional loans.
2. The bank sells the purchased commodity to the customer on a deferred payment basis at a pre-agreed, clear fixed profit rate.
3. After having the commodity owned by customer and being at his possession, he sells it at the market price to a party different to that which the bank has purchased the commodity from.

4. Sell amount resulting from step 3 above is then credited to customer's account that will be used by him to settle his financial liabilities and conventional loans.⁴⁰

3.12.3. Controversial issues on the legality of *Tawarruq*

PERMISSIBLE	IMPERMISSIBLE
<p>1. The International Council of <i>Fiqh</i> Academy (ICFA), which is an initiative of the Organization of Islamic Conferences (OIC), has enveloped</p> <ul style="list-style-type: none"> • That the original manifestation of a <i>Tawarruq</i> is a <i>Shariah</i>. • However, the (ICFA) then went on to state that more complex transactions known as reverse commodity <i>Tawarruq</i>, or simultaneous organized and reverse <i>Tawarruq</i>, are not <i>Shariah</i> compliant. <p>2. AAOFI issued <i>Shariah</i> standard on the application of <i>Tawarruq</i> on Standard No.3. The procedure is when two contracts will be executed.</p> <ul style="list-style-type: none"> • First contract involves the purchasing of commodity on deferred which call as <i>Murabahah</i> or <i>Musawamah</i>. <p>Second contract involves the selling of the commodity to third party on cash basis which was stated in Standard No 30 (2).</p>	<p>1. In the Muslim World League resolution on <i>Tawarruq Munazzam</i>, it is not permissible to include an unclear transfer of the title of the relevant good.</p> <p>2. In 2007, Husain Hamid Hassan, which is the Head of the <i>Shariah</i> Board of Dubai Islamic Bank and a member of many councils of Islamic economics made it clear to the Middle Eastern media that the contemporary Muslim jurists unanimously agreed a few days ago, on the non-permissibility of <i>Tawarruq</i>, based on its improper implementation. Apart from being implemented improperly, the decision was also made based on some ambiguities that exist in <i>Tawarruq Munazzam</i> (pre-arranged <i>Tawarruq</i>).</p> <p>3. In 2009, OIC <i>Fiqh</i> Academy ruled Organized <i>Tawarruq</i> is impermissible to be use in Islamic finance.</p>

Therefore, *Murabahah* and *Tawarruq* is permissible according to its application and *Fatwass* from various Islamic countries but it subject to certain condition as only permit genuine *Tawarruq* and prohibit organized *Tawarruq*.

3.13. Findings

On the basis of the legal arguments on *Murabaha* and *Tawarruq*, there are some findings toward the views from the proponents and opponent of the aforementioned products.

Firstly, both resolutions for approving *Murabaha* and *Tawarruq* assert that the actual involvement of the real good in the relevant transactions is strongly required.

⁴⁰ n.a. 21st January 2003. "Abu Dhabi Islamic Bank Launches New Product. United Arab Emirates".(Newspaper)

Actual transfers of the real good are explicitly required as an essential condition according to *Al Barakah* Resolution i.e. resolution issued by Kuwait Finance House (KFH).

A *Fatwass* of Shaikh ' Abd al-'Aziz Ibn Baz i.e. Highest Legal Authority of Saudi Arabia also indicates that the bank must purchase and take possession of the goods 'without the client being bound to fulfill his spoken or written promise.

In the Muslim World League resolution on *Tawarruq Munazzam*, it is not permissible to include an unclear transfer of the title of the relevant good. This means that no skips of actual transfer procedure of the real good are required in the permissible *Tawarruq*. These requirements imply that both *Murabaha* and *Tawarruq* are legitimized because they are neither monetary nor nominal transactions, but are transactions based on the actual buying and selling of goods.

Secondly, *Murabahah* and *Tawarruq* also mention that the profit margin or additional cost must firstly agreed by both parties. It means the price is fixed and there is no interest will be charged to the customer in the case of default payment. In contrast, it can be considered that the source of prohibition of interest in conventional interest-based loans is regarded as an opportunity cost of the monetary good (Shinsuke, no year).

Fatwas of *Shariah* board, Faisal Islamic Bank, Egypt, *Fatwas* No. 16 states that according to *Shariah* principles and in case of *Murabahah* sale the original price of the good and all costs incurred by the original buyer to obtain should be clear and known to the buyer in *Murabahah* transaction and therefore scholars define the sale of *Murabahah* as the sale of commodity with its current costs plus an agreed upon profit. Hence all *Murabahah* sale information should be clarified in all sale documents placed in the file of each contract.⁴¹ It same to *Tawarruq* transaction whereby the *Murabahah* contract s involved in the transaction.

⁴¹ n.a. “*Murabahah* : How it works”. (<http://theaccountinghypothesis.wordpress.com>)

It can be said that instead of *Murabahah* and *Tawarruq* are valid according to the conditions of valid sale but the only features which render those transaction is valid are the actual involvement of the goods and disclosure of the cost. The two features are important in *Murabahah* and *Tawarruq* as compared to other products in Islamic finance. However, in *Tawarruq* transaction, the permissibility is only on the genuine of *Tawarruq*, not organized *Tawarruq* or *Tawarruq Munazzam* which is prohibited by many scholars.

In light of the above, it can be said that the aim in structuring of the financing *Murabahah* and *Tawarruq* arrangement to ensure conformity with *Shariah* lies in ensuring that the Islamic financier, at some time, takes legal title to the goods. The application of *Murabahah* and *Tawarruq* in Islamic banks also should be supervised by the authorize body to ensure that it operates according to *Shariah*.

4. Conclusion

It can be concluded that *Tawarruq* transaction practice by Islamic banks is according to *Shariah* guideline. Even though there are different views and stands towards the legality of *Murabahah* and *Tawarruq* but the *Fatwas* from AAOIFI confirmed that the products are permit to be used in current practice. However, the requirement outlined by AAOIFI shall be fulfilled by Islamic banks to ensure that product is permissible to be used i.e. no elements of *Riba*, *Gharar* and *Maysir*.

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