Journal of Economics and Management Sciences
Fall 2020, Volume 1, No.2, pp 59-67

A THEORETICAL ANALYSIS OF MUSHARAKAH MUTANAQISAH IN ISLAMIC BANKING

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ABSTRACT

This paper critically evaluates the concept of Musharakah Mutanaqisah financing and its related issues. In recent years, Islamic banks and financial institutions have frequently practised Musharakah Mutanaqisah as an investment and financing tool, along with Muzarbah, Murabahah and Ijarah. Musharakah Mutanaqisah is a partnership contract between two parties, wherein one partner gradually buys the whole property. After the formation of partnership, the transaction starts and sale and purchase of the property take place between the partners. It is imperative that this buying and selling should not be stipulated in the partnership contract. Moreover, the buying and selling agreement must not be conditional to the partnership contract. The researcher concludes with a few suggestions and recommendations to improve and get acceptance of this product in future.

Key Words: *Musharakah Mutanaqisah, Islamic banking, Home financing*

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Introduction

Banking system has become imperative part of our society and the backbone of national economy. But most of the banking businesses and products are illegal and Haram according to Islamic teachings. It is the need of the hour that substitutes for these Haram and illegal businesses and products should introduced according to Islamic principles. Islamic banking and finance are flourishing throughout the world as a practical reality. Not only new Islamic banks and financial institutes are being established, but already existing commercial banks are also introducing different forms of Islamic banking. This change gives the message that Muslims have awakened to seek knowledge and do research and they are ready to implement Islam in all spheres of life. This change also indicates the established fact that Islam is a practical religion in all times and it guides the people of all eras. Islamic economic system has been evolved in a form that every justice seeker says that Islam is the true emancipator for the humanity.

As the alternatives of interest based business, Islamic concepts of Shirkat (partnership) and Muzarbat and Murabahah are considered as ideal. The word Musharakah is used for Shirkat. There are different forms of Musharakah, Musharakah Mutanaqisah is one of them.Though the concept of Shirkat and its related rules and problems are given in Nasoos (Quran and Hadith) and books of Fiqh (Islamic jurisprudence), but Musharakah Mutanaqisah is considered a modern concept. Therefore, the concept of Musharakah Mutanaqisah is not discussed in books of Fiqh under traditional Shirkat. The concept of Musharakah Mutanaqisah was introduced by an Arab researcher Samy Hamoud in his Ph.D. thesis in 1976. In 1978, Islamic banks of Jordan started using it as a tool of financing and investment. In 1979, a conference of Islamic financial institutions was held in Dubai and the conference formally allowed Islamic banks, financial institutes and companies to use Musharakah Mutanaqisah as a financing tool and investment. In Pakistan, Islamic Ideology Council has recommended Musharakah Mutanaqisah in different departments of financing (Abd al Rahman, 2015). Islamic banks usually use Musharakah Mutanaqisah for house and automobile financing.

In this form of investment, a client goes to bank and tells that he is in need of a house and he is short of the required finance. The bank offers the client partnership to buy or construct a house, by specifying the shares of each of them in the capital partnership. Let us assume that the client and the bank decide to construct a house jointly, with 80 percent share of the bank and 20 percent share of the client. The client does all labour and gets house built in his supervision, because he has to live in the house while the bank only provides finances and has no practical involvement in the construction of house. When the construction is over, the client shifts in the house. Now the bank asks the client to pay the rent of its 80 percent share of the house. The client, not only, pays rent to the bank according to its share, but also starts purchasing the share of the bank in installments. As the client pays installments, the share of the bank in the house starts

reducing and resultantly, the rent of the bank also starts decreasing. This practice continues until the client purchases the bank's whole share in the house. In this case, the client pays the installment and the rent separately.

The agreement of Musharakah Mutanaqisah is implemented in three phases:

1. The first contract is about Shirkat-e-Melk (share in property). So the house is purchased/constructed with the joint money of the bank and the client, in which, usually the share of the bank is higher than that of the client. Both the bank and the client jointly own the property of the house and Shirkat is according to the ratio of capital. For example, if the client has provided 30 percent money, he will own the property with same percentage.
2. The second contract is for Ijarah (rent). The bank divides his share of the house in units and rents it out to the client. Client pays rent for a known period.
3. The third contact is of Bay' (sale). Client purchases a unit from the share/equity of the bank in the house, on fixed cost, with each installment. Whenever the client purchases a unit, one unit of the bank's share in property decreases. So the client stops paying the rent of that unit and gradually, the ownership of the house is transferred to the client and he stops paying the rent (Usmani, 2005).

So Musharakah Mutanaqisah is combination of Shirkat-e-Melk (share in property), Ijarah (rent) and Bay' (sale). Now we discuss Shari'ah status of these three concepts separately.

In the first phase, both parties start Shirkat-e-Melk by purchasing/constructing the house. It is not wrong according to Shari'ah because both parties jointly purchased the house to establish Shirkat. So there is no suspicion about its Shari'ah legality. Fuqaha defined Shirkat-e-Melk as:

شركة الملک هی ان یملک متعدد عینا او دینا بارث او بیع او غیرها۔[4]

When some people become owners of some property or liability through inheritance, trade or some other way, it is called Shirkat-e-Melk."

In the second phase, the bank rents out its share in the house to the client and this share is the surety of the bank till the ownership is transferred to the client. If the property is damaged during this period, it is considered the loss of the bank. This contract of Ijarah is a real phenomenon, not hypothetical. A question arises; can one Sharik (share-holder) transfer his share to another Sharik (share-holder)? The answer is that Fuqaha have consensus on the legality of giving on Ijarah (renting out) combined asset to a partner.

[4]Al-Shami, Muhammad bin Abdeen , *Tanveer ul Absar ma Raddul Muhtar*, (Ryadh: Dar Alimul Kutab 2004) , P-466, V-6

Though there is difference of opinion about giving it on Ijarah to non-partner. Allama Haskafi writes in Durre Mukhtar:

وتفسد ای الاجارة ایضا بالشیوع ـــ الا اذا آجر کل نصیبہ او بعضہ من شریکہ فیجوز، فجوازہ بکل حال [5]

"Ijarah of combined asset is illegal, however, if whole or a part of one's property is given to one's partner, it is legal and it is legal in all forms."

Allama Ibne Qudamah Maqdasi has also pointed out the consensus of Fuqaha that a Sharik can rent out his whole share or a part of share to another Sharik. However, renting out share to non-partner is illegal according to Imam Abu Hanifa and Imam Zufar while other jurists consider it legal also (Ibne Qudama, 2007).

In the third phase, the bank is selling its property units to the client, who is also its partner. The bank sells its units to the client from time to time. A formal separate contract is done for the sale of each unit. Though the time period of these sales is the same of the time period of Ijarah contract of the remaining units, however, the situation of these two contracts is different. The property units, which are rented out, are not sold and the units that are sold, are not rented out.[6] The question arises here can any Sharik sell his share in combined asset or not. A noted researcher of Fiqah Hanfi Ibne Abideen writes:

لو باع احد الشریکین فی البناء حصتہ لاجنبی لایجوز ولشریکہ جاز [7]

This means that if a partner has a share in both the land and the building/structure of a joint house, there is consensus that the sale of his share is legal. If he sells his share of the building to a partner, it is also legal consensually. However, the sale of only building/structure to a non-partner is illegal. As the bank sells its share to its Sharik in Musharakah Mutanaqisah, so there is no doubt in its legality.

The conclusion of the above discussion is that all contracts (Shirkat, Ijarah and Bay') are essentially justified. If these agreements are made separately, there is no doubt and ambiguity about them.

Objection of Safqatah Fi Safqatah

Despite the separate legality of these three agreements, the objection of Safqatah Fi Safqatah can be raised on Musharakah Mutanaqisah because there is a general agreement between the bank and the client about all three contracts and Shirkat, Ijarah and Baey are

[5]Al-Haskafi, Alauddin , *Durre Mukhtar ma Raddul Muhtar*, (Ryadh: Dar Alimul Kutab, 2004). P-48, V-8

[6]Team of Darul Ifta wal Irshad, *Ghair Soodi Bainkari*, (Karachi: Jamia tur Rasheed), P-112

[7]Al-Shami , Raddul Muhtar, P-300, V-7

correlated with one another. Safqatah Fi Safqatah means that one contract is conditional to another contract. For example if a person sells a commodity with the condition that the buyer will also give some loan to the seller. There is evidence from a Hadith.

لايحل بيع وسلف ولاشرطان فى بيع[8]

"Bay' (sale) and loan are illegal (simultaneously) and two conditions are not halal in one Bay'."

To make one contract conditional to another contract is also illegal according to Hanbalites, who have soft view on conditions of Bay'. Allama Ibne Qudamah explains in Al-Mughni, a famous book of Hanbalite Jurisprudence (Fiqh-e-Hanbali):

الثانى (اى النوع الثانى من الشرط) فاسد، وهو ثلاثة انواع احدها: ان يشترط على صاحبه عقدا آخر كسلف او قرض ، او بيع، او اجارة، او صرف الثمن او غيره، فهذا يبطل البيع[9]

"The second category of conditions of Bay', which is illegal, is further classified into three types. One of which is a situation, in which one party imposes the condition of another contract to the second party, this condition will make Bay' illegal. These contracts include loan, Bay', Ijarah etc."

The answer to this objection is that the problem is created by not differentiating Wadah (promise) from Shart (condition), while both are quite different. To agree on a contract, while making it conditional to another contract, with the term that if one contract is not implemented, the second will be null and void is different from the situation in which a Wadah is made compulsory, separate from the contract, while the previous contract is not declared invalid if Wadah is not fulfilled. However, the promised person can force the partner to fulfill the promise through judicial process.[10]

About Bay' Al-Wafa[11], some Fuqaha (jurists) are of the opinion that it is not lawful to impose condition of Wafa within contract of Bay'. However, if Bay' is not conditional and fulfillment of promise and the contract are separate, it is justified and fulfillment of promise will be enforced. The following description from Fatawa Khaniah is note-worthy:

وان ذكر البيع من غير شرط ثم ذكر الشرط على وجه المواعدة جاز البيع ويلزمه الوفاء بالوعد لان المواعدة قد تكون لازمة فتجعل لازمة لحاجة الناس[12]

"If the condition is not mentioned as a part of Bay' contract, but as a promise, separate from the contract, the Bay' will be legal and the fulfillment of the promise is necessary,

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[8]Al-tirmizi, Muhammad bin Eesa, *Jame Tirmizi*, Hadith No. 1234, (Ryadh: Maktaba Al-Maarif , 2009)

[9] Ibne Qudama ,,*Al- Mughni*, P-290, V-4

[10]Team of Darul Ifta wal Irshad, *Ghair Soodi Bainkari*, P-115

[11]A sale (Bay) contract in which the seller has the right, as stipulated in the contract, to repurchase the underlying property from the buyer by refunding the purchase price.

[12] Qazi Khan, Al-Hasan bin Mansoor, *Fatawa Khaniyah*, (India: Noul Kishoor) , P-126, V-3

because the fulfillment of promise is made compulsory keeping in view the need of people."

This rule is for the time when Bay' contract is unconditional initially and promise is made after the implementation of Bay'. However, Fuqaha (jurists) have explained that if promise is made before Bay' contract, the same rule applies. Qazi Ibne Samawah Al-Hanafi writes about Bay' Al-Wafa:

وكذا لو تواضعا الوفاء قبل البيع ، ثم عقدا بلاشرط الوفاء فالعقد جائز، ولا عبرة بالمواضعة السابقة[13]

"If they have agreed on the condition of Wafa before Bay' contract, and then they made the Bay' contract without condition of Wafa, the Bay' contract is legal and the previous agreement will not affect it."

A group of Mutakhireen-e-Ahnaf (the later Ahnaf jurists) have given Fatwa (verdict) that a Wadah, separate from Bay' contract, whether made before or after the contract, is not associated with the contract and will not be included in the category of Safqatah Fi Safqatah and it will lawful.[14]

There arises an objection that even if contract was finalized after Wadah and it was not mentioned in Bay' contract, however, Wadah is the basis of the contract. So it does not seem different from conditional Bay'. Mufti Taqi Usmani replied to this objection in detail in his book. According to him, if Bay' contract is conditional to another contract, both contracts are based and pendent on each other and they can be fulfilled and abolished simultaneously. This pendency creates disturbances and problems. If Wadah is made along with Bay' contract, Bay' is not imperfect or it is not based on Wadah. However, this Wadah can be enforced.[15]

Still there is another objection. The above-mentioned discussion proves that if Wadah is separate from Bay', the buyer will be forced to fulfill his Wadah but he will not be compelled to make promise. But in Musharakah Mutanaqisah, the bank does Ijarah contract on the basis that the client will buy the house share from the bank. If the client does not promise to buy the house, the bank will refuse the contract. In this case, client is not only forced to fulfill the promise, he is bound to make promise and the base of Bay' contract is the Wadah. The answer to this objection is that the client is not bound to make promise. He has the freedom not to contract with the bank.[16]

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[13]Ibne Qazi, Shaikh Badruddin Mahmood bin Israel, *Jame Al-Fasoolain* , (Karachi: Islami Kutab Khana) P-237, V-2

[14] Lakhnavi, Molana Fateh Muhammad, *Itrul Hidaya*, (Deoband: Maktaba Nashrul Quran), P-109

[15]Usmani, Muhammad Taqi, *Bahoos fi Qazaia Fiqhiya Muaasra*, (Qatar: Wazarat Auqaf) , P-245

[16] Team of Darul Ifta wal Irshad, *Ghair Soodi Bainkari*, P-116

Other Objections

Another objection on Musharakah Mutanaqisah is that neither partnership is the intension of the bank, nor it is interested in Bay' or Ijarah. The bank aims at financing and it uses Bay' and Ijarah to earn profit through financing. This objection is invalid because Bay' and Ijarah have permanent separate effects, which appear in different time periods in Musharakah Mutanaqisah. So the bank and the client take risk for their shares in property during whole period of Musharakah Mutanaqisah e.g. 20 years. If they face loss, they bear the loss as per their share in the property. Similarly, the bank receives rent from the client for the units, it owns in property, not of the units, which it has sold to the client.

Some scholars criticize Musharakah Mutanaqisah and say that the bank fixes the rent of the house on the basis of interest rate of commercial banks. Mufti Dr. Abdul Wahid writes:

Customary Islamic banks fix the price of a commodity or rent with an alternative rate, in which KIBOR (Karachi interbank offered rate), the interest rate for internal monetary dealings of banks, has fundamental role. It means that Islamic banks fix the price or rent on the basis of KIBOR and with the change in KIBOR, the price or rent keeps changing. To use interest rate as a standard to fix price or rent is inconsistent with interest free Islamic economic system (Abdul Wahid, 2008).

This is very valid criticism but it is need of wisdom and prudence that this method should be declared legal to promote interest free banking, because if interest free Islamic banks demand more return as compared to KIBOR, people will not trade with these banks and if they demand lesser return in comparison with KIBOR, the other banks will not let them function. [17]

However, it is suggested that the bank should fix the rent on the basis of city, and locality, not on the basis of interest rate. For example, there is difference in the rents in Islamabad and Lahore and small cities. How can bank charge same rent in different cities. Same is the case for different localities of one city.

Moreover, the following issues should be given consideration in Musharakah Mutanaqisah to make it legal according to Shari'ah:

1. The bank should avoid insurance for the security of the asset; instead it should opt for Takaful. Both the bank and the client should share Takaful and circumspection expenditures, according to their share in property. This argument is invalid that finally the client will be the owner of the assets, so he should pay all expenditures.

[17] Team of Darul Ifta wal Irshad, *Ghair Soodi Bainkari*, P-123

2. Both the client and the bank must finance, whether in form of cash or asset, e.g. the land on which building is being constructed or the instruments that will be required during Shirkat (partnership) activities.
3. Though both the client and the bank can take each other's share on rent on a fixed rate and for a fixed time period in Musharakah Mutanaqisah, however, every Sharik (partner) will be responsible for the security of his share all the times.[18]

Conclusion

Musharakah Mutanaqisah consists of Shirkat, Ijarah and Bay' and this is a modern concept to avoid interest based banking. It is usually used for house financing in Islamic banks. Apparently, objection of Safqatah Fi Safqatah is raised on Musharakah Mutanaqisah, but in reality, this objection is invalid because the bank doesn't make one contract conditional to another, however, promise is sought for the fulfillment of these contracts. The researchers have some other concerns on the methodology of Musharakah Mutanaqisah, some of these concerns are very valid and different steps are required to address these concerns. On the whole, Musharakah Mutanaqisah is a better financing tool to abolish interest based banking system. Therefore, more research and deliberation should be done to harmonize it with Shari'ah.

[18] *Al-Maayeer Al- Shariah*, (Bahrain: Accounting and Auditing Organization for Islamic Financial Institutions) P-213

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