

# ISLAMIC FINANCE 1ST

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## - Tawarruq Contract -

### DEFINITION

Tawarruq consists of two sale and purchase (S&P) contracts. The first involves the sale of an asset by a seller to a purchaser on a deferred basis. Subsequently, the purchaser of the first sale will sell the same asset to a third party on a cash and spot basis. It is deemed permissible based on the general permissibility of sales in Islamic law.



### وَأَحَلَّ اللَّهُ الْبَيْعَ وَحَرَّمَ الرِّبَا

"Whereas Allah SWT has permitted trading and forbidden usury."  
(al-Baqarah: 275)

### COMPONENTS

#### CONTRACTING PARTIES

- Seller & purchaser.
- Natural person or a legal entity with legal capacity.
- Seller in the 1st S&P contract shall not be the purchaser in the 2nd S&P contract in the same tawarruq.
- Each S&P contract in tawarruq may be entered through an agent.

#### ASSET

- Recognised by Shariah, valuable, identifiable and deliverable tangible/intangible assets.
- In existence and owned by the seller in each respective S&P contract.
- Can be a whole asset or part of the whole asset.
- Not allow to trade in tawarruq: gold, silver and currencies; assets to be constructed or under construction; and assets which are debt in nature.
- Can take physical possession (qabd haqiqi) or constructive possession (qabd hukmi).
- Same asset shall not be the subject matter of multiple tawarruq at any one time.
- May be entered into on a group of assets between the same contracting parties at the same time.

#### PRICE

- Mutually agreed.
- Disclosure of cost and profit shall be complied for S&P contract – tawarruq on murabahah basis.
- Price can be on spot or deferred basis, or in instalments or a lump sum bullet payment.

### VARIOUS ARRANGEMENT IN TAWARRUQ

#### ARRANGEMENT OF WAKALAH IN TAWARRUQ

Any contracting party in the tawarruq may appoint an agent to act on his behalf, in which the wakalah contract shall be arranged in a contract separately from the S&P contract of the tawarruq. Dual-agency may be implemented in a tawarruq.

#### ARRANGEMENT OF WA'D (PROMISE) IN TAWARRUQ

Purchaser may provide a promise to purchase asset from seller upon its acquisition from a third party; shall not contain any condition that requires the purchaser to promise that the asset will be sold to a third party, or its original seller.

#### ARRANGEMENT OF ASSURANCES IN TAWARRUQ

Tawarruq may be arranged with assurances, in the form of Shariah contracts of kafalah (guarantee), takaful, rahn (pledge) or hamish jiddiyah (security deposit).

#### ARRANGEMENT OF IBRA' (REBATE) IN TAWARRUQ

Seller may give rebate on part or the entire outstanding selling price of the S&P contract in the form of a discount to the purchaser upon pre-payment and/or early settlement.

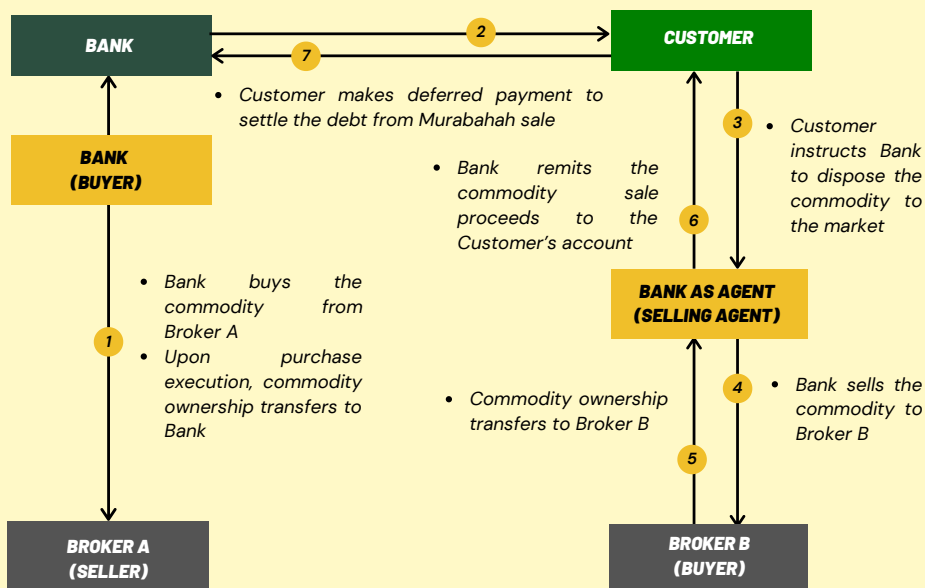
#### ARRANGEMENT OF TAWARRUQ WITH TA'WIDH (COMPENSATION) AND/OR GHARAMAH (PENALTY) IN TAWARRUQ

Late payment charges shall consist of:

- Compensation for actual loss suffered by the seller, may be recognised as income to the seller.
- Penalty, which shall not be recognised as income and shall be donated.

### EXECUTION PROCESS OF TAWARRUQ/ COMMODITY MURABAHAH FINANCING

- Bank sells the commodity to the Customer at Cost + Profit (Murabahah)
- Commodity ownership transfers to Customer & debt is created (deferred sale)



### DISSOLUTION OF SALE AND PURCHASE CONTRACT IN TAWARRUQ

S&P contract in tawarruq is dissolved when:

- Purchaser exercises defect option to terminate S&P contract;
- Any contracting parties exercise mutually agreed option to terminate S&P contract; or
- Both parties mutually agreed to terminate S&P contract.

### COMPLETION OF TAWARRUQ

- Full settlement of selling price;
- Transfer obligation to pay selling price to a third party through hiwalah al-dayn;
- Waive right to receive outstanding selling price through a rebate by seller; or
- Full muqassah (set-off) of debt obligations between contracting parties.