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DORMANT PARTNERSHIP IN ISLAMIC LAW COMPARISON WITH MALAYSIAN PARTNERSHIP ACT 1961

A THESIS SUBMITTED IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR THE DEGREE OF MASTER OF COMPARATIVE LAW

BY

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Acknowledgment

For the first time when I sat down to write a thesis it was not an easy task for me to do, due to some difficulties in respect of the English language, because when I did my first degree most of the subjects that I have taught were conducted in Arabic language. Therefore I have done my best in order to make the thesis understandable as far as possible. In addition I have also faced some difficilties due to the shortage of time and materials particularly in the area of practicing mudarabah in the banking system.

However after I completed the thesis I would like to thank International Islamic University Malaysia for granting me the opportunity to join this course and also for the financial assistance that has given. My appreciation and thanks to every person that has helped me, particularly to my lecturers in M.C.L. My greatest thank is also to my supervisor Asso.Prof.Dr. A. Shahbari Salamon who was always encourged me and my colleges to contribute something to the knowledge.

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Hafiz Ali Ismail
Malaysia-Kuala Lumpur
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INTRODUCTION

Dormant partnership (Mudarabah) is considered to "constitute one of the most important contracts in the Islamic law of obligation". Moreover mudarabah as a contract is considered as the proper way in order to correct the process of the Islamic economy so as to get rid of any usurious transactions. No doubt, in the present time, there is a new tendency among most of Islamic countries to introduce gradually the Islamic forms of transactions in various aspects of the economic life as a lawful substitute for that which may deem to be contradictory to the religion of Islam. In the area of commercial transactions the contract of mudarabah has started to play a great role in the economic life especially in respect of the banking system.

The objective of this study is to identify the nature of mudarabah partnership and its modern application to show the particular nature of mudarabah the study is related to Malaysian Partnership Act 1961.

The study will be conducted in comparison between the two systems. Therefore, each chapter will be divided into parts examining mudarabah partnership first and then its counterpart in Malaysian Partnership Act 1961. Comparative analysis will be in the end of each chapter.

The whole study contains six chapters. The first is devoted to the discussion of mudarabah partnership in Islamic law, the

definition of mudarabah in the literal sense as well as the definition in the juristic sense in which the particular nature of mudarabah partnership may be identified. Since mudarabah seems to resemble others contracts a distinction is also being made. The definition of partnership in the Malaysian Act 1961 will be examined as well. Before conducting a comparison between the two systems, the law which governs the practice of both mudarabah and partnership will be provided.

The conditions of validity in relation to the two systems is discussed in chapter two in addition to their kinds.

The modern application of the rule of profit-loss sharing in mudarabah is seen to be confusing. Therefore, more attention is given to the elaboration of the rule according to the understanding of both the traditional and the contemporary jurists.

The authority of the mudarib in mudarabah partnership and the partner in Malaysian Partnership Act 1961 are surveyed in chapter three. Special attention is given to the invalidity of mudarabah, its causes and subsequent consequences. The reason for this attention is that the jurists of Islam are not in agreement in respect of the conditions of validity of mudarabah. The various legal positions that given to the mudarib also needs to be explained.

The rights or duties of the parties in mudarabah, and the rights or duties of the partners under Malaysian Partnership are surveyed in chapter four. The surveyed of rights and duties in addition to the liabilities of the partners under Act 1961 are

conducted in some length. Some cases are discussed as well.

In both systems the occurrence of certain events may lead to the termination of the contract. The termination if often has a consequence that come out as a result of the termination. This will be explained in chapter five. The Malaysian Partnership Dissolution, also, is discussed in some length.

The last chapter is devoted to a comparative study of mode of practising mudarabah partnership in the banking system in three countries, namely Sudan, Malaysia (Bank Islam Malaysia Berhad) and Pakistan. The surveying of the mode of practising mudarabah in the banking system of those countries constitutes a part from discussing mudarabah in Islamic law as general. Since such practising is suppose to be fully under the Islamic law of mudarabah and in accordance with the rules of Shari'ah.

CHAPTER ONE

PART ONE

Literal Definition of Mudarabah Partnership

In the literal sense, mudarabah is derived from the Arabic word "daraba" which has several meanings: In 'Lisan al-Arab', the word is used to mean to travel, to go from place to place, or to make a journey for a trading purpose, or to go in the earth seeking for Allah's bounty, and also it means to gain.[1] The word is being mentioned in the Holy Qur'an in a number of verses. For instance, Allah (SWT) says in surah Al-Nisa:

"When you travel through the earth"[2]

The word in this verse is used to mean the state of being in a journey. In another verse Allah (SWT) says in surah Al-Baqarah:

> *"Charity is for those in need who in Allah cause are restricted from travel, seeking for trade or work"*[3]

Also in surah Al-Muzzammil Allah (SWT) says:

> *"Others travelling through the land, seeking of Allah's bounty"*[4]

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[1]Ibn Menzor, Lisan Al-Arab,2 p.32.

[2]The Holy Qur'an, Surah Al-Nisa:101.

[3]The Holy Qur'an, Surah Al-Baqarah: 273.

[4]The Holy Qur'an Surah Al-Muzammil: 20.

It is clear that the word is used in the later verses to indicate seeking the bounty of Allah by travelling through the earth.

In this sense, the word "mudarabah" is used synonymously with the two Arabic words; namely, Al-Qirad or Al-Muqaradah. The former is used by the people of Iraq. Whereas, the later is used by the people of Hijaz. The word "mudarabah" is used in the books of Hanafi, Hanbali and Shi'ah schools, however, "Qirad"[5] or "muqaradah"[6] is often used in the books of Shafie, Maliki and Zahiri schools. Mudarabah is also known as "Muamalah"[7], but the word has no use except in a narrowest scope.

Juristic Definition

In the juristic sense, mudarabah can be defined as a contract of partnership between two parties or more in such a way that the capital comes from a party (Rab al-Mal),[8] whereas, the work comes from the other (Mudarib).[9] The realized profit is to be shared by them according to their agreement, the loss, however, should be borne by the party who provides the capital . Mudarabah is also

5Al-Qirad: in Arabic language means to lend also it means to cut.

6Muqaradah is derived from the word qaradah which means to weigh or to equal.

7Muamalah. is derived from the word "Amal" which means to work or to transact.

8The words: financier, provider of the capital, the owner of the capital are used to refer to (Rab al-mal or Sahib al-amal); that is the party who provides the capital.

9The words: worker, labourer, entrepreneur are used to refer to the party who provides the work (the mudarib).

defined as the kind of partnership on condition that the capital is to be found by one and the labour and work by the other. The owner of the capital is called Reb Al-Mal and the worker mudarib.[10]

A contemporary jurist defines mudarabah as a form of partnership where one of the contracting parties called (Sahib Al-Amal) financier provides specified amount of capital and act like sleeping or dormant partner, while the other party called (mudarib) entrepreneur provides the entrepreneurship and management for carrying on any venture, trade industry service with the object of earning profit.[11]

From the given definition, one can deduce the basic characteristics of mudarabah as follows:

1. Mudarabah is a contract that may be entered into between two parties or more by an agreement, may either be express or implied
2. The party who provides the capital must remain always a dormant party
3. The other party must contribute the skill only and perform the work
4. Mudarabah is a particular kind of partnership that differs from partnerships in the Islamic law
5. Mudarabah is a partnership in the profit only, and the provider should bear the loss alone

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[10] The Mejelle Article. ١٠٥٤

[11] Ali Khan Niazi Islamic Law of Contract, p.232.

6. The parties in mudarabah must share together the realised profit.

Distinction Between Mudarabah and Hire

Sometimes people may confuse between mudarabah and the contract of hire in Islamic law, (contract of employment) In the contract of hire, a party is obliged to perform a work for another, as a consideration, a given sum is to be paid to him.[12] For the first look, it may seem that the contract of hire resembles that of mudarabah. Mudarabah, however, is a partnership in the sense that one provides the capital whereas the other provides the work. The profit is to be shared by them. Moreover the shares of the parties in mudarabah must be predetermined and fixed in advance.

Distinction Between Mudarabah and the Contract of Loan

Mudarabah is a particular form of partnership. In this sense, it is partnership in the profit. The capital and either the profit or the loss should be returned to the owner. The contract of loan, however, is to return back to the owner, the sum borrowed without any decrease or increase.[13] Mudarabah may resemble the contract of loan which contains the element of usury, Since, under this contract, the borrower must return the exact sum plus increase (interest). This increase is prohibited in the Islamic law, because

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[12] Wahbah Al-Zuhili, Al-Fiqh Al-Islami Wa Adillatuh, pp. 766-67.

[13] Id at 720.

it is predetermined to be positive irrespective of the outcome of the business, which may be positive or negative.[14] In mudarabah, however, the profit is lawful, because both parties contribute towards the work, which is not the case in the contract of loan when it contains an increase.

Definition of Partnership Under Malaysian Act 1961

A partnership is defined in section 3(1) of Partnership Act 1961 as:

> *"The relation which subsists between persons, carrying on business in common with the view of profit"*[15]

The basic elements that can be derived from the definition are:

1. The business

The term "business" includes every trade, occupation, or profession, but it should be observed that not only every occupation aimed to realize profit constitutes a business, for instance, two or more persons may jointly possess a property even though they may not be partners.[16]

2. Two persons or more must carry on the business

Partnership is considered to be existent in case that there

[14]Ziauddin Ahmed, Some Misgivings About Islamic Interest Free Banking, p.25.

[15]S. 3(1) of the Malaysian Partnership Act 1961 (Reviewed 1974).

[16]R.C.I' Anson Banks, Lindley & Banks on Partnership, p.9.

are two persons or more carrying on the business.[17] Therefore, if the business is run by a person or more on behalf of himself and others there may be a partnership. In the contrary, if a several persons run the business on behalf of one person, in this case there will be no partnership.[18]

The term "persons" is said to include artificial, as well as, natural persons.[19] Accordingly, there may be a partnership between a person and a limited company.

The crucial element in the existence of the partnership is that the business must actually be commenced, otherwise the partnership is deemed not to be existent.

3. There must be a profit

As regard to the profit, it is essential that the partners must share in the net profit which resulting after payment of all outgoings.[20] But, if the share is payable out of gross returns, the recipient would not be a partner in the business. However, if the partnership is formed for purpose other than to gaining a profit, such as to avoid payment of a tax, there is a real albeit ancillary, profit element, then it may be permissable to infer that the business is being carried

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[17]Id. at 10.

[18]Ibid.

[19]Ibid.

[20]Ernest H. Scamell, Lindley on the Law of Partnership, p.12.

on "with a view of profit".[21] But, if the partner has entered into partnership where there is no real profit, then he would not properly be a partner.[22]

The determining rules as regard to the existence of partnership

Under section 4 of malaysian act 1961 there are certain rules that play a crucial role in determining whether the partnership exist or not, these rules as follow:

(a) Joint tenancy, tenancy in common, joint property, common property, or part ownership does not itself create a partnership as to anything held or owned, whether the tenants or owners do not share any profits made by the use thereof;[23] Thus in Davis v Davis,[24] A father left his two sons his business and three freehold houses in equal shares as tenants in common. They let one of them and employed the rent in enlarging the workshops attached to the two houses. They continued to carry on the business. They each drew out from it a weekly sum, but no accounts were kept. The rent of the third house was divided between them.

Held, by the Chancery Division:

There was a partnership as to the business but not as to the

[21] Ibid.

[22] Id at 13.

[23] S. 4(a) of Malaysian Act 1961 (Reviewed 1974).

[24] Da"is v Davis (1894) 70 LT 265.

freehold houses.

(b) The sharing of gross returns does not itself create a partnership, whether the persons sharing such returns have or have not a joint or common right or interest in any property from which or from the use of which the returns are derived;[25] In Cox v Coulson,[26] the defendant was a manager of a theatre an agreed with one Mill to provide the theatre and pay for the lighting and for the playbills. He was to receive 60% of the gross takings, whilst Mill was to provide and pay for a theatrical company and provide the scenery and receive the remaining 40%. The plaintiff was injured by a shot fired by an actor during the performance of a play at the theatre. She sought *inter alia* to make the defendant liable on the ground that he was a partner of Mill.

> **Held,** by the Court of Appeal:
> The defendant could not be made liable on this ground because he was not a partner, for by the English equivalent of s4(b) of the Partnership Act 1961 the sharing of gross returns did not by itself create a partnership.

(c) The receipt by a person of a share of the profits of business is prima facie evidence that he is a partner in the business, but the receipt of such a share, or of a payment contingent on or varying with the profit of a business, does not of itself

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[25] S. 4(b) of Malaysian Partnership Act 1961 (Reviewed 1974).

[26] Cox v Coulson (1916) 114 LT 599.

make him a partner in the business; and in particular

i. The receipt by a person of a debt or other liquidated profits of a business or liable as such,

ii. a contract for the renumeration of a servant or agent of a person engaged in a business by share of the profits of the business does not itself make the servant or agent a partner in the business or liable as such;[27] In Abdul Gaffoor v Mohamed Kassim & Ors,[28] in 1912 the plaintiff joined the firm of Mohammed Kassim & Co. as delivery clerk. He later became a branch manager. The business had been founded by Mohammed Kassim and had branches in Malaysia, Myanmar and India.

In a document written in Tamil langauge dated 26 March 1925 it was provided that the 'Kanapatta labhanashtam' ('balance found') should be divided into 79.5 shares and apportioned between the plaintiff, the defendants and others, according to their respective shares which are set out in detail in the document. The signatories were all described as 'kuttalimatgal' ('persons who are renumerated by a share in the profits' or 'partners').

The plaintiff claimed that this document proved that he was a partner in the business and, as such, was entitled to a certain share of the profits. The

[27] S.4(c) (ii) of Malaysian Partnership Act 1961 (Reviewed 1974).

[28] Abul Gafoor v Muhammed Kassim (1931-32) FMSLR 19.

defendants denied that there was a partnership and said that the relationship between themselves and the plaintiff was that of employer and employee.

Held:

On the true construction of the document and on the evidence, there was no partnership. The true relationship between the parties was that of employer and employee. Sharing of profits as renumeration for an employee does not of itself make the employee a partner.

iii. a person being a widow or a child of a deceased partner, and receiving by way of annuity a portion of the profits made in the business in which the deceased person was a partner, is not by reason only of such receipt, a partner in the business or liable as such,

iv. the advance of money by way of loan to a person engaged or about to engage in any business on a contract with that person that the lender shall receive a rate of interest varying with the profits, or shall receive a share of the profits, arising from carrying on the business, does not of itself make the lender a partner with the person or persons carrying on the business or liable as such. Provided that the contract is in writing and signed by or on behalf of all the parties thereto;[29]

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[29] S.4 (c)(iv) of the Malaysian Partnership Act 1961 (Reviewed 1974).

In Re Young, ex perte Jones,[30] Lloyd Jones and Young entered into an agreement by which it was provided that Lloyd Jones should lend 500 pounds to Young in consideration for the employment to Lloyd Jones of 3 pounds per week out of the profits. Lloyd Jones was also to assist in the office, to have control over the money advanced and to be empowered to draw bills of exchange. He also had the right to enter into a partnership within a period of 7 months. A question arose as to whether Llyod Jones was a partner.

Held, by the Queen's Bench Division:

He was not a partner.

v. a person receiving, by way of annuity or otherwise a portion of the profits of a business in consideration of the sale by him of the goodwill of the business is not, by reason only of such receipt, a partner in the business or liable as such;[31] In Re Gieve, ex Parte Shaw,[32] John Shaw was an outside stock and share dealer. He died leaving his widow his sole legatee. In 1892 she assigned the business and goodwill to Gieve and Willis under an agreement by which **inter alia** she was to be paid a annuity of 2,650 Pounds by the buyers. Gieve and Willis carried on the business until Willis died. Gieve carried

[30] Young Re ex Parte Jones (1896) 75lt 278.

[31] S.4(c)(v) of the Malaysian Partnership Act 1961 (Reviewed 1974).

[32] Gieve Re, ex Parte Shaw. (1899) 80 Lt737 p.22