

Interest rate versus profit rate in the light of Islamic maxim: al-ibratu fil uqūdi lil maqāsidi wa ma'ānī lā lil alfāzi wal mabani

Saheed Abdullahi Busari^{a*}, Haruna Babatunde Jaiyeoba^b,
Mohamad Sabri Zakaria^c

^{a,c}*Kulliyah Of Islamic Revealed Knowledge and Human Sciences, International Islamic University Malaysia*

^b*International Institute for Halal Research and Training (INHART), International Islamic University Malaysia*

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ABSTRACT

The concept of interest and profit is as old as the history of commercial transactions because, in Jahiliyyah (ignorant) period, people transact business based on interest and sometimes for profit. These concepts are also not alien to conventional financial practice, except that many people cannot distinguish between interest-based and profit-based transactions. As much as shariah encouraged commercial transactions of common and fair benefit through exchanging commodities and money, it equally emphasised the need for fair play and justice for entire market stakeholders. This study aims to explore and explicates literature on the differences between conventional bank interest rates and the Islamic bank profit rate in financing. The study will describe the contractual pictures of both methodologies to analyse the convergent and divergent features between interest-based loans and profit-based financing. This study uses the Islamic legal maxim theory of "In contracts, the effect is given to intention and meaning and not words and forms" (Al-‘ibratu fil uqūdi lil maqāsidi wal ma'ānī lā lil alfāzi wal mabānī) as a fundamental principle in determining shariah compliant profit based in commercial transactions. This study arrived at findings on the distinctive divergent between the interest rate and profit rates in financing. The study identifies issues those convergent trigger concerns among researchers and critiques in contemporary applications can be resolved based on contractual intent and meaning rather than words and forms. This study came up with recommendations for improving the operational status of Islamic financial transactions in the profit rate.

* Corresponding author. *E-mail address:* saheed@iium.edu.my

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1. Introduction

Interest are proceeds received by lenders of a loan as compensation for the use of money over some time. In contrast, profit is the net income resulting from financial transactions based on trading. The interest rate seems similar to the profit rate because both income revenues accrue to the contractual party. However, there are differences based on the purpose and implication of the two terminologies. The interest rate is loan based while the profit rate related to trading (; Zolea, 2022). However, there are challenges of interpolation in recent transactions whereby one is used in place of the other, or both are considered to mean the same. Although the rate of interest is typical to conventional banking and transaction of loans between the lender and the borrower, yet some practitioners might assume it is similar to the profit rate because of some apparent similar features when the application of profit rate seems unfair, stricter, unattractive and less accessible to the people. One of the challenges of interest rates is the increase in the cost of borrowing, and people will spend less, resulting in reduced demand for goods and services. This led to a fall in the level of inflation. On the other hand, a low-interest rate regime usually triggers higher consumption of goods and services, reducing individual and household savings (Dechow et al., 2010; Deyoung & Rice, 2004).

Despite the challenges of interest rates on housing loans, the importance of a home cannot be overemphasized because of its significant psychological effect and socioeconomic stability on family subsistence. Homeownership remains one of the fundamental social entities that provide family protection for every unit, especially children and women. The cost of owning a home in modern society is huge. However, many people need to have their homes as compulsory life achievements to guarantee family integration and protection. However, the considerable massive cost of owning an individual's home has increased the significance of home financing projects by governments, financial institutions, and cooperative societies based on conventional loans and Islamic financing schemes.

This study explores the differences between conventional bank interest rates in loans and the Islamic bank profit rate in financing. It also explicates essential the implication of the Islamic legal maxim theory of "In contracts, the effect is given to intention and meaning and not words and forms" (Al-‘ibratu fil uqūdi lil maqāsidi wal ma’ānī lā lil alfāzi wal mabānī) in the shariah compliance status of incomes in commercial transactions. Therefore, the remaining parts of this paper explore a literature review of critical terminologies and the divergence of interest and profit rates in the contemporary context. It follows the implication of the Islamic legal maxim on the interest and profit rate, then the discussion and conclusion of the study.

2. Literature review

2.1 Interest rate

Interest rate is the fee paid by the borrower to the lender on loan for the use of money for a specific period as agreed upon. The interest rate is calculated based on the money loan divided by the amount borrowed. Since the borrowing is advancing consumption by paying for the privilege, the fee charged as interest on the loan is the compensation for the loan period. The determination of the interest rate formula (I/pt) includes interest (I) fee paid in a specific period, principle (P) amount of money before the interest charge, time (T) period involved from the beginning of loaning, and complete repayment and interest rate (r) in decimal of fraction. Simple interest (also known as Nominal Interest) is interest based on the original loan or saving amount, compound interest, borrowing money, fixed rate interest, variable rate interest, interest measures, annual percentage rate (APR), annual equivalent rate (AER) (Faure, 2014). Interest is the proceed received by a lender on the use of money, whereas profit is received by the owner of an asset, investment, or enterprise. There are short-term and long-term interest rates. The former are short-term borrowings and trading of government financial papers between financial institutions and individuals,

institutions, and governments. The long-term interest rates relate to government bonds due within an extended period. The long-term interest rate has a minimum of 5 years of maturity (OECD, 2020).

Interest charge on loan is determined based on the interest rate, time, and loan amount. For example, the formula for simple interest (SI) = principle amount (P) x interest rate (I) x time (T). Simple Interest = $P \times I \times N$. The simple calculation of interest rate on loans depicts that the time value of money is a significant factor in the calculation of interest charge. In contrast the interest rate is a predetermined rate charged rationally on loan (Aizenman et al., 2017).

Interest is prohibited in Islam because the shariah encourages mutual contractual benefit in a business transaction, acquisition of items with money for sale rather than making extra without economic reference. Transactions involving interest are categorically prohibited in Islam based on several pieces of evidence in the Quran and Sunnah thus: "Whatever you pay as interest so that it may increase the wealth of people does not increase in the sight of Allah" (Qur'an, 2007, 30:39). Also, "O ye who believe! Devour not usury, doubled and multiplied; but fear Allah; that ye may (really) prosper" (Qur'an, 2007, 3:130).

2.2 Profit rate

Profit is the income received as proceeds by an asset, investment, or enterprise owner. In Islamic finance, the profit rate involves the sale of commodities at a markup price to customers depending on the nature of the contract. There is a contract based on arrangements with customers to disclose cost and profit (Murābahah); there are others based on pure trading without disclosing cost and profit rather understood as the market price of the goods. According to the Egyptian Fatwa Committee, it is not permissible in Islamic law to specify a fixed percentage of profits of 10,000 on the asset. Instead, it is permissible to determine the profit percentage by having a profit rate of 10% annually.

The study of Puspitaningtyas et al., (2018) explicates that even though mainstream profit is materialistic, spiritual profit seems value based and has long-run positive socio-economic and psychological impacts on the contractual parties. The profit rate in Islamic finance is based on the profit-sharing ratio (PSR) agreed upon by the contractual parties. The sharing ratio depends on the Islamic contract employed. For instance, in mudarabah contracts, a profit ratio of 95% accrued income from the business to the financial institution and 5% to the customer. However, in the musharakah contract, profit and risk sharing are used because contractual partners are parties to the underlying asset and sharing of profit and loss.

2.3 Time value of money

The time value of money is an essential concept in economics and finance, which indicates that money has more value as time passes. It is interpreted that money takes command of the overconsumption of goods and services; however, delaying money in possession of a borrower for whatever reason deserves compensation. Lenders usually argue that borrowing people with free interest is foolish because of the challenges of credit risk and inflation risk confronting the amount of money. Firstly, credit risk shows that the future is unknown, and it is impossible to be sure whether the loan will be received money being received. Secondly, the inflation risk suggests that the value of money at the time of borrowing may. Hence, there is a need for compensation for these risk interests (Faure, 2014).

The advocacies of the concept of the time value of money argue that the present value of money is more like to increase over time and should be worth more in the future because money has the potential earning capacity to increase value over time. The rational investors opined that money held with the other party is a disadvantage to the owner. The earlier it is claimed, the better and therefore prefer to receive their money as early as possible (present) rather than delayed (future). Considering the perception that money has the potential value to increase in the present rather than the future, an average investor, trader, and business person will receive their money in the present rather than the future (Alzaabi & Nobanee, 2022). This is why discounted cash flow (DFC) analysis is essential in the conventional system because DCF help to

estimate the return on investment based on the time value of money that money claimed today is better than future since it can be reinvested to make a gain (Dow, n.d.). The mainstream economist believes there is a potential difference between the present value and the future value of money. When money is earned today and invested, it has a potentially higher value than when it is earned in the future.

Apart from the economic and social time value of money from the conventional perspective, it has consideration in Islam for its permissibility based on certain parameters. Although the concept of interest rate is spurred by the essence of the time value of money to the capitalist for the guarantee on inflation and function of money with time changes, shariah scholars differ around the juristic interpretation of time money of value. According to Khir, (2013) time value of money is relatively applied to the concept of bilateral *ibra'* (*da' wa ta'ajjal*) "when a creditor forfeit part of the debt when the debtor pays earlier than scheduled" in Islamic jurisprudence. This recognises the essence of the time value of money to the contractual parties, especially the creditors who got reduced scheduled for earlier settlement. Juristic evidence in support of *da' wa ta'ajjal* was based on the hadith thus: "The hadith of Ibn Abbas –(RTA): When the Messenger of Allah (PBUH), wanted to expel Banu al-Nadir, they said: O Messenger of God, you commanded our expulsion, and we owe unresolved debts to the people," then the prophet (PBUH) recommend (*da' wa ta'ajjal*) between the contractual parties to enhance earlier settlement of debt with the forfeit of part payment (Al-Qutni, 2010, no. 2963). However, others views that the concept of (*da' wa ta'ajjal*) is similar to the prohibition of exchange of spot payment with the deferred sale as mentioned in another hadith thus: "of Ibn Umar – (RTA) said: The Messenger of Allah (PBUH), forbade the sale of a deferred payment with an increment"(Al-Aitham, 2010). Therefore, the application of *da' wa ta'ajjal* in modern financial transactions must be based on future sales and not a present transaction to avoid the inherent *riba* in the transaction. Hence, money time value is permissible in shariah when it is associated with the price of a commodity to avoid *riba* (Hamza et al., 2017).

3. Islamic legal maxims

Islamic legal maxims are principles developed to rule several issues. These maxims are methods of ruling in Islamic jurisprudence derived from the primary sources of Islam law. Islamic legal maxim simply provides general jurisprudential rules for an issue that falls under specific chapters. There are primary and secondary legal maxims(Az-Zarqa, 1989). This section focuses on the secondary maxim: *Al-'ibratu fil uqūdi lil maqāsidi wal ma'ānī lā lil alfāzi wal mabānī* that falls under the primary maxim thus: *Al-Umūru bi-maqāsidihā*.

"In contracts, the effect is given to intention and meaning and not words and forms" (*Al-'ibratu fil uqūdi lil maqāsidi wal ma'ānī lā lil alfāzi wal mabānī*) means consideration is given to intent and meaning over wordings and forms. The Islamic legal maxims: "In contracts, the effect is given to intention and meaning and not words and forms" (*Al-'ibratu fil uqūdi lil maqāsidi wal ma'ānī lā lil alfāzi wal mabānī*) is a stand-alone maxim that is related to the universal legal maxims (*Al-Qawā'id al-Fiqhiyyah al-Kubra*) that is unanimous among the four schools of Islamic jurisprudence with some differences in its implications. This auxiliary maxim on the contract is in connection with the first of the universal maxims "Matters are (judged) by their intents" (*Al-Umūru bi-maqāsidihā*) that is widely in many chapters of *fiqh* literature (Shettima et al., 2016). The Maxim is derived from the hadith of the prophet (Every action according to intention) (Al-Bukhārī, 2002). The importance of intention in every action determines its completeness and correctness, however, action is only rewarded with intention. It is fair to say that actions without intention will earn no reward in Islam (Busari et al., 2021). Intention encapsulates several jurisprudential issues, such as "Things are with their purposes." Worship is not recorded except for Allah's sake and regulation of human activities like social, economic, and cultural engagement will be rewarded when they obey Allah's injunction (Al-Latif, 2003).

The sum of this legal maxim: "In contracts, the effect is given to intention and meaning and not words and forms" (Al-‘ibratu fil uqūdi lil maqāsidi wal ma’ānī lā lil alfāzi wal mabānī), is that shariah invalidates transactions that its outer structure is complete and correct, but its connote some elements of prohibitions.

3.1 *The divergence between interest and profit rate in commercial transactions*

Interest differs from profit because the former is the income received by a lender on the use of a fund, while profit is the proceed received by the owner on the transfer of ownership of an asset, investment, or enterprise. The study by Sekreter et al. (2012) found that the profit rate of Islamic banking is based on the concept of a profit-loss sharing system between contractual parties. This study suggests that the convergence between the conventional interest rate and Islamic bank profit rate is because the current Islamic finance institutions have limited global economic coverage trying to survive in this world because customers of both conventional and Islamic banks want to maximise their incomes. Hence, Islamic banks use profit equalisation reserve to protect depositors' income against the reduction to stabilise the rate of return to depositors by a bank (Sekreter et al., 2012).

The concept of profit may be generally understood as a reflection of income achieved by individual or corporate business. However, shariah has certain parameters to determine permissible and prohibited profit (income achieved) from transactions. Nevertheless, the purpose of any investor or trader is to make a profit. Hence, it is worthwhile for any investor or trader to abstain from illegal profits and income. Profit earned from businesses must be lawful and free from all prohibited activities. An example of unlawful profit is earning from prohibited products and services that can harm the fundamental existence of humanity, animals, and the environment, such as spoiled food, contaminated drinks, and harmful substances. Are also prohibited in shariah profits earned from the transaction of prohibited objects such as dealing in intoxicants and narcotics and selling dead meat and pork. Therefore, every profit generated by trading in prohibited professions is a malicious gain generated by corrupt contracts, gross unfairness and monopoly, and exploitation.

A review on Islamic economics opined that investment behaviour of time value of money is generally common to every market, as well as Islamic-based markets, because zero rate time preference, as claimed by others, has no justification. However, realising a favourable time preference based on the time value of money within the Islamic framework is a necessary condition, especially when the time value of money is not considered a predetermined fixed value (Khan, 1991). An excellent example of Islamic consideration of the value of money between the present and future is the bay' mu'ajal (forward contract). However, Islamic jurisprudence does not specify whether there should be a difference in the present and future price of the commodity on a forwarding contract; rather the difference is based on the market forces of demand and supply (Khan, 1991).

A deferred sale (Salam) is a sale in which the commodity's capital (the price) is paid in advance, and delivery of goods is delayed for a term agreed upon by the contractual parties. This sale is permissible based on the principles of Istihsan (juristic preference) (Zuhaili, 2006). Ab initio, there is a shariah source that forbids the sale of what you do not own based on the shariah intent of protecting contracting parties from deception and unlawful consumption of other persons' property because of the element of ambiguity. The prophet PBUH was reported to have said: "When you purchase food grains, do not sell them until you have taken possession of them" (An-Naisābūrī, 2006, no. 3653). However, another preferred reference permits a forward contract (Salam) with conditions. This is evident from the thus:

"O believers! When you contract a loan for a fixed period of time, commit it to writing" (Qur'an, 2007, 2:282).

"Whoever engages in advances transaction of something, let him advance in a known measure, and in a known weight, for a known term" (Al-Bukhārī, 2002, no. 2125).

According to the International Islamic Fiqh Academy (2021), the salam contract is suitable for financing agricultural operations, especially the stages before the production and export of profitable goods, by

another way of buying it in the company of a salam contract and remarketing them at profitable prices. A salam contract can also be used to finance handicraftsmen small producers, farmers, and manufacturers by giving them necessary production requirements in the form of tools, equipment, or raw material as forwarding capital (Salam capital) to access some of their products and remarketing them.

3.2 *The implication of Islamic legal maxims on the divergence of profit rate and interest rate*

There are fundamental Islamic legal maxims related to several branches of Islamic jurisprudence. Although there are exceptions, the fundamental Islamic legal maxims apply to many branches of Islamic jurisprudence (As-Subuki, 1991). One of the fundamental legal maxims is “matters with its purposes”, which has several secondary maxims like; “In contracts, the effect is given to intention and meaning and not words and forms” (Lahsasnah, 2014a; Busari et al., 2021). However, this secondary maxim (Al-‘ibratu fil uqūdi lil maqāsidi wal ma’ānī lā lil alfāzi wal mabānī); is an important shariah maxim that is widely accepted and used by scholars with few contrary rejections that effect might be intended for a specific purpose based on the word and the form (Al-Hassan, 1997). Moreover, some of the jurists that accepted the maxim clarified the need to distinguish between a general statement in relation to the textual reason from statements attached with specific indications that signal the specificity of the context of its application (As-Subuki, 1991).

The maxim: “In contracts, the effect is given to intention and meaning and not words and forms”; is evident that the essence of intention in every contractual agreement should not be limited to the wordings and form, instead consider the intent of the contractual parties and the meaning of the textual format of the contract based on the general understanding of the contractual parties. According to Lahsasnah (2014), to arrive at the intent and meaning for consideration in a contractual agreement, there is a need to consider the phenomena of words and formulas in the contract, whether it is a categorical statement or metaphorical. Also, consideration of a statement might be based on the wordings or the meaning depending on the presence of an attached indicator (qarīnah). For instance, when a buyer tells sellers that they will pay you later, but you can hold this other personal commodity, this is considered as rahn (pledge) contract despite the word and form of the conversation. Similarly, the gift is considered a sale when the giver attaches a condition of exchange for another benefit. Similarly, when the seller mentioned that the sales are free, its consideration is not a sale contract but a gift (hibah) contract (Lahsasnah, 2014b).

Islam permits trading and forbids usury in any form and shape. Several commercial transactions might seem to have trading, but the basic intent and the meaning eventually suggest its riba and forbidden in Islam. Therefore, the verse of the Quran that supports trading “But Allah has permitted trading and forbidden interest” (Qur’an, 2007, 2:275). , it excludes all forms of transaction that have the element of riba, even though it is done in the name of buying and selling or exchanging commodity and price.

Interest refers to every extra earned on capital, but in shariah terminology, interest is the unlawful taking advantage in the exchange of money or homogenous commodity. There are two main kinds of interest (riba); firstly, (1) the riba fadhli is the excess taken in exchange for specific commodities of the same kind and encountered in the hand-to-hand purchase. This riba fadhli is evident from the hadith that mentioned the six ribawi commodities: The Prophet said, "Sell gold in exchange for equivalent gold, sell silver in exchange for equivalent silver, sell dates in exchange for equivalent dates, sell wheat in exchange for equivalent wheat, sell salt in exchange of equivalent salt, sell barley in exchange of equivalent barley, but if a person transacts in excess, it will be usury (riba). However, sell gold for silver any way you please on the condition it is hand-to-hand (spot) and sell barley for a date any way you please on the condition it is hand-to-hand (spot).”

Although there are arguments about whether the ribawi commodities can be extended or limited to the six elements in the hadith, most scholars hold that analogical extension is possible on items that share similar illah (causal effect) with any of the mentioned six ribawi commodities. Imam Abu Hanifah viewed that the weight and the volume are common characteristics of these six ribawi commodities and, as such,

as a significant common basis of comparison for an analogical extension to other goods that have weight or volume and are being exchanged, with the same commodity will fall under the rules of *riba al fadhli*. However, the Shafii school of law identifies the basis of comparison for analogical extension from the six *ribawi* elements as what serves as a medium of exchange (currency) or edible. Similarly, Maliki schools opined that edible and preservable commodities are features of the analogical extension. Since the higher objective of the prohibition of *riba* is to ensure justice and remove unfair play between the contractual parties, contemporary jurists are unanimous that other commodities that share similar causal effects, such as having weight and it is a medium of exchange, will be categorised as *ribawi* commodities.

Secondly, (2) *riba nasihah* is an increase for a delay in debt repayment. This is the additional interest charged on one exchanged item for the other in return for delayed payment. The purpose of additional quantity to a contractual party is because of the delay in payment from the other. The *riba nasihah* (increase for the delay) was common practice during the pre-Islamic era of ignorance (*jāhiliyyah*), and the prophet (PBUH) prohibits this based on the hadith thus: “there is no *riba* except in *nasihah* (increase for a delay)” (Al-Bukhari, 1994, no. 2178).

There are forbidden *ribawi* sales, such as (1) *bay’ īnah* (sale and buy-back). It is selling the item (the commodity) for a deferred price over its value, then reselling it to its owner at a lower price in cash and in advance, or for the merchant to sell the commodity at a deferred price with the condition that it be sold to him for a lower price in cash before receiving the first price. The sale of the sample is considered a loan in the form of a sale to facilitate obtaining the increase (interest) in another way. The same is the sale of *tawarruq*, which is the entry of a third party and the purchase of the commodity from the buyer at a lower price (Nursyamsiah & Kayadibi, 2012). Imam Nawawi explicates in *Sharhu sahih Muslim* that *bay’ Inah* is one of the *hiyal* (juristic device) prohibited because it is a form of trick used to consume *riba* that is prohibited in Islam (An-Nawawi, 1994).

Muzabanah sale (sales of unmeasured wet produce): It is the estimation of the wet that is still on the palm trees for a specified amount and selling it in exchange for an amount of the ripe dates. The jurists are unanimous that this sale is not permissible because the Prophet (PBUH) forbade the sale of *muzabanah* and *muhaqalah* for fear of falling into *riba* because of the ignorance of unknown elements in the amount of wet on the palm. Moreover, the same is the sale of olives for oil and wheat for flour (M. A. Khan, 2018).

Bayatani fī bay wāḥid (two sales in one sale): There are many jurists’ sayings about the meaning of two pledges of allegiance, including Selling the commodity for two prices if it is cash, and if it is credit (debt), and the two contracting parties separate without agreeing on a specific price. The buyer has the option to sell the commodity at a specified price in cash or a deferred plus price. Selling a commodity to someone for a specific price in exchange for a condition that he buy another commodity from him, such as if the seller says to the buyer: I sold you the car for two thousand on condition that you sell me your house for twenty thousand, and here are two deals in one deal. The seller requires the buyer to use the commodity for a certain period after he sells it. These images are from two pledges in a non-permissible one, by agreement of the *fuqaha’*, and they are prohibited from the door of blocking excuses (Arbouna, 2007).

Bay’ ma lam yuqbad (Selling without possession): It is the sale of something before taking possession of it, and this form of sale is forbidden concerning food only because of the ease of changing food, unlike other commodities based on the hadith, “Do not sell something until you have possessed it” (As-Shaibani, 2001, no. 1318). However, *salam* (differed contract) is permissible to sell other than food before receiving it; Because the legal texts from the Sunnah of the Prophet, which indicate not to sell before taking possession, were all limited to the prohibition of selling food before receiving it.

Bay Kālī bi Kali: (sales of debt for debt): It is the sale of debt for debt, and the debt may be sold by the debtor himself or by a non-debtor, and the jurists agreed on the prohibition of selling debt to a non-debtor, but there is a difference in the ruling on selling debt to whom it is, where the tap permitted it, and the public prohibited it except in certain circumstances, and for this selling several pictures, including: Rescission of what the debtor owes in return for something whose receipt is delayed after the time of rescission, whether due to the maturity of the debt or not. Selling the debt in exchange for another debt to a non-debtor, even if

the term of the debt is immediate non-receipt of the price in the event of establishing the salam sale contract, i.e. delaying the capital of the salam sale contract. The jurists permitted the debt sale from the debtor because the impediment to repayment is the inability to deliver it and the end of the need for the borrowed money, i.e. delaying the repayment of the debt without increasing its amount (Ehsan, 2013). The intent and meaning of contractual agreement are most significant in modern commercial transactions like discounting commercial papers such as selling post-dated cheques for less than their present price in the same currency, which has an element of usury based on sales of debt for debt (Majma Fiqh al-Islami, 1998, no. 64). A fixed percentage of profit on a bank deposit for an investment account is also considered as *riba* based on the intent and meaning of the contract because a fixed percentage is a form of guarantee on the expected return to the investment depositors (Al-Badarin, 2021).

Similarly, a premium or prize given by banks to their customer and an account holder is permissible in as much as it is not preconditioned in the contractual agreement. The intent and meaning matter here because of the case of the hadith of the prophet (PBUH), “he borrowed a cow from a man to repay when there is *sadaqah* when the time comes he ask Rafii (a companion) to give his cow but could not find except a bigger flock and the prophet commanded him to give him from it because the best of you is that which repay the loan in the better form” (An-Naisābūrī, 2006, no. 1600).

4. Discussion

The concept of interest and profit is as old as the history of commercial transactions because, in the *Jahiliyyah* period, people transact business based on interest and some profit. These concepts are also not alien to conventional practice, except that many people cannot distinguish between interest-based and profit-based transactions.

This study identifies a significant difference between the profit rate and interest rate based on the unpinning intent and meaning of the contractual agreement. Although the conventional interpretation refers to interest as earning from financial transactions, interest in Islam is based on certain parameters related to the contractual intent and meaning far from words and formats. Profit is permissible in the *shariah* because it is based on trading that enhances justice and fairness between the contractual parties. However, trading or commercial transactions that violate the principles of actual sale and trading are prohibited in *shariah* based on the principles of “In contracts, the effect is given to intention and meaning and not words and forms”. This principle does not mean that words and format are not necessary in a contract; rather it takes significant consideration in the determination of the validity and legality of the contract. Sometimes, the contract’s name and form may not represent the intent and implicative meanings of the terms in the contract. Therefore, the intent is important based on the prevalent market culture that does not violate *shariah*’s fundamental principles. This is why the Quran also emphasised the claim of a distinction between sales-based (profit) and *riba*-based (interest) because there seems to be some similarity between them, especially when there is an exchange of money or commodity between contractual parties.

The exchange of money or commodity is not prohibited in itself in *shariah* but rather rendered prohibited because of the associated conditions similar to *riba fadhli* (exchange of same commodity at a different rate) or *riba nasihah* (postponement interest). In conventional practice, interest is a fee charged for the use of money or commodity in the name of profit, while a dividend is an appropriation for profit based on an actual sales agreement. Interest must be paid compulsorily at the time it requires payment. On the other hand, the payment of dividends is voluntary. The interest rate is fixed, while the interest rate is fixed in the case of preferred shares and fluctuates in the case of equity shares. The concept of a loan is acceptable in Islam but must not be based on interest rather (*qard hassan*) a benevolence loan that is free of interest. Many Islamic banks’ products rely on financing rather than the loan because of the challenge of interest inherent in the loan system.

5. Conclusion

This study explicates that despite the general perception of profit as income achieved by individual or corporate business, however, yet, shariah has certain parameters to determine permissible and prohibited profit (income achieved) from transactions. The interest-based transaction may be viewed in conventional as earning but has elements of injustice and unfair dealing, which is while it is categorically prohibited in shariah. The loan acceptable in Islamic transactions is a benevolence loan (qard hasan) that is free of interest. This benevolence loan is different from the conventional loan based on interest charged on the use of money for some time. The theory of Islamic legal maxims posits that "In contracts, the effect is given to intention and meaning and not words and forms" (Al-‘ibratu fil uqūdi lil maqāsidi wal ma’ānī lā lil alfāzi wal mabānī) is evidence to suggest the significance of intent and meaning in a commercial transaction. The intent of contractual parties and the meaning of the terms in the agreement is of utmost importance in consideration. The study found that despite the recognisable impact of words and form in contracts, intent and meaning are prioritised to decide the direction of the validity and legality of the contractual agreement. This study suggests the further need to conduct a comparative case study on applying interest and profit in contemporary financial institutions.

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About the Authors

Saheed Abdullahi Busari, PhD is an Assistant Professor of Islamic jurisprudence and legal theory at the International Islamic University of Malaysia. His primary research work lies between the intersection of the principles of Islamic Jurisprudence and socioeconomic realities. He has taught courses in Islamic Jurisprudence, Islamic legal theory, Halal & Haram in Shariah, Islamic social finance, Leadership & Management, Islamic Inheritance and endowment, sustainability, and parenting. His extensive approach to multidisciplinary teaching and research centres around the convergence and contribution of Islamic jurisprudence and legal theory to social and natural sciences. Saheed Abdullahi Busari is the corresponding author and can be contacted at: saheed@iium.edu.my

Haruna Babatunde Jaiyeoba, PhD is an Assistant Professor at the International Institute for Halal Research and Training (INHART), International Islamic University Malaysia (IIUM). He has a multidisciplinary background with research interests in employee engagement, business management, halal entrepreneurship, sustainability, modern and behavioural finance, etc. He has been involved in prominent consultancy projects and conducted several research-related training. He is an active researcher with several indexed

publications in his areas of expertise. He welcomes research collaboration in his areas of expertise. Haruna Babatunde can be contacted at: harunjaiyebab@iium.edu.my

Mohamad Sabri Zakaria, PhD is currently the head of the department Fiqh & Usul al-Fiqh, AHAS, KIRKHS at International Islamic University Malaysia. He teaches the Juristic study of financial contracts, the Juristic study of Zakat, the Juristic study of Banking, contemporary Juristic Issues, Maqasid Shariah, and Islamic Legal Maxims.

Authors' contributions

Saheed Abdullahi Busari conducted the research and revised the article. Haruna Babatunde Jaiyeoba conceptualised the research idea and editing. Mohamed Sabri Zakariyah reviews the shariah values of the paper.



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