MUSHARAKAH

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Major Categories

- Classical Contracts of Partnership
  - Sharikatul Inan
  - Sharikatul Wujooh
  - Sharikatul A'mal

Modern Corporation Partnerships

- Company limited by shares
- Diminishing Partnership

Explaining the Classical Contracts

- Sharikatul Inan
  - Joint Venture
  - Pre-agreed profit-sharing ratio
    - Shares do not have to be equal
  - Losses borne in the ratio of capital invested

- Sharikatul Wujooh
  - No capital required
  - Purchasing goods on credit
  - Profit distributed after sales

The basic rules and Features of Musharakah

- **Musharakah means relationship established under a contract by the mutual consent of the parties for sharing of profits and losses, arising from a joint enterprise or venture.**
- **Investments are contributed by the parties hereinafter referred to as partners.**
- **Profits shall be distributed in the proportion mutually agreed in the contract.**

The basic rules and Features of Musharakah

- *Capability of Partners:* **Must be sane & mature and be able of entering into a contract. The contract must take place with free consent of the parties without any fraud or misrepresentation.**
- **If one or more partners choose to become non-working or silent partners, the ratio of their profit cannot exceed the ratio which their capital investment bears so the total capital investment in Musharakah.**

The basic rules and Features of Musharakah

- It is not allowed to fix a lump sum amount for any of the partners, or any rate of profit tied up with his capital.
- A management fee however, can be paid to the partner managing the Musharakah provided the agreement for the payment of such fee is independent of the Musharakah agreement.
- Losses are shared by all partners in proportion to their capital.

The basic rules and Features of Musharakah

- All assets of Musharakah are jointly owned in proportion to the capital of each partner.
- All partners must contribute their capital in terms of money or in kind at an agreed valuation.
- Share capital in a Musharakah can be contributed either in cash or in kind. In the latter case, the market value of the asset shall determine the share of the partner in the capital.

The basic rules and Features of Musharakah

- The presence of the asset: This means the price and the asset itself.
- The rate of profit sharing should be determined: The share of each partner in the profit earned should be identified at the time of the contract.
- If however, the ratio is not determined before hand the contract becomes void.

Distribution of Profit

- The ratio of profit for each partner must be determined in proportion to the actual profit accrued to the business, and not in proportion to the capital invested by him.

- It is not allowed to fix a lump sum amount for any one of the partners, or any rate of profit tied up with his investment.

ILLUSTRATION

- If A and B enter into a partnership and it is agreed between them that A shall be given Rs. 10,000/- per month as his share in the profit, and the rest will go to B, the partnership is invalid.
- Similarly, if it is agreed between them that A will get 15% of his investment, the contract is not valid.
- The correct basis for distribution would be an agreed percentages of the actual profit accrued to the business.

OBSERVATIONS

- If a lump sum amount or a certain percentage of the investment has been agreed for any one of the partners, it must be expressly mentioned in the agreement that it will be subject to the final settlement at the end of the term, meaning thereby that any amount so drawn by any partner shall be treated as on account payment and will be adjusted to the actual profit he may deserve at the end of the term.
- But if no profit is actually earned or is less than anticipated, the amount drawn by the partner shall have to be returned.

Sharing of loss

- **In the case of a loss, all the Muslim jurists are unanimous on the point that each partner shall suffer the loss exactly according to the ratio of investment. Therefore, if a partner have invested 40% of the capital, he must suffer 40% of the loss, not more, not less, and any condition to the contrary shall render the contract invalid. There is a complete consensus of jurists on this principle.**

- ***Profit is based on the agreement of the parties, but loss is always subject to the ratio of investment.***

Termination of *Musharakah*

- *Musharakah* is deemed to be terminated in any one of the following events:

(1) Every partner has a right to terminate the Musharakah at any time after giving his partner a notice to this effect, whereby the Musharakah will come to an end. In this case, if the assets of the Musharakah are in cash form, all of them will be distributed pro rata between the partners. But if the assets are illiquid, the partners may agree either on the liquidation of the assets, or on their distribution or partition between the partners as they are.

Termination of *Musharakah*

- **IN CASE OF A DISPUTE**

  If there is a dispute between the partners in this matter i.e. one partner seeks liquidation while the other wants partition or distribution of the non-liquid assets themselves, the latter shall be preferred, because after the termination of musharakah, all the assets are in the joint ownership of the partners, and a co-owner has a right to seek partition or separation, and no one can compel him on liquidation. However, if the assets are such that they cannot be separated or partitioned, such as machinery, then they shall be sold and the sale-proceeds shall be distributed.

Termination of *Musharakah*

(2) If any one of the partners dies during the Musharakah, the contract of Musharakah with him stands terminated. His heirs in this case, will have the option either to draw the share of the deceased from the business, or to continue with the contract of Musharakah.

(3) If any one of the partners becomes insane or otherwise becomes incapable of effecting commercial transactions, the Musharakah stands terminated.

Termination of *Musharakah* without closing the business

- **If one of the partners wants termination of the Musharakah, while the other partner or partners like to continue with the business, this purpose can be achieved by mutual agreement. The partners who want to run the business may purchase the share of the partner who wants to terminate his partnership, because the termination of Musharakah with one partner does not imply its termination between the other partners.**

Termination of *Musharakah* without closing the business

- However, in this case, the price of the share of the leaving partner must be determined by mutual consent, and if there is a dispute about the valuation of the share and the partners do not arrive at an agreed price, the leaving partner may compel other partners on the liquidation or on the distribution of the assets themselves.

Diminishing Musharaka

Used in Islamic Banking for Property Financing

- **1 partner promises to buy equity from the other on a gradual basis until transfer takes place**
- **Buying & Selling of units or equity**
  - **Should not be part of the Musharaka contract**
    - **2 contracts in one is not permissible**
- **Permissible for either partner to rent the property during the period that transfer has not been completed**

Procedure for Diminishing Musharaka

- 1.To create **joint ownership** in the property

  2.Giving the **share** of the **financier to** the **customer** on **rent.**

  3. **Promise** from the customer to **purchase** the units of **share** of the **financier.**

  4. Actual **purchase** of the **units** at different **stages** through a formal offer & acceptance

  5. **Adjustment** of the **rental** according to the **remaining share** of the financier in the property.