# Realities of Islamic Finance Practice: A Critical Comparison between Tawarruq and Riba-Based Lending within the Maqasid al-Shariah Framework

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**DOI: https://dx.doi.org/10.47772/IJRISS.2025.92900009**

**Received: 17 November 2025; Accepted: 26 November 2025; Published: 17 December 2025**

## ABSTRACT

This extended abstract critically compares tawarruq-based financing in Islamic banking with conventional interest-based lending through the lens of maqasid al-Shariah. Using qualitative document analysis of tawarruq contracts, Shariah standards and resolutions, and peer-reviewed scholarship, the study evaluates legal form, economic substance, and ethical outcomes. Findings indicate that while tawarruq satisfies the formal elements of a sale contract, its organised implementation often results in synthetic cash-financing that mirrors the outcomes of interest-bearing loans. Key concerns include nominal rather than meaningful possession of commodities, agency conflicts when the bank acts as both counterparty and customer's agent, limited disclosure of costs, and a predominant use for consumption smoothing that can heighten household indebtedness. Assessed against maqasid al-Shariah, these practices risk undermining hifz al-mal, fairness, and the reduction of hardship. The paper proposes system-level reforms: ensuring genuine and demonstrable possession, providing real agency options for customers, enhancing price and cost transparency, and redirecting product development toward risk-sharing or asset-productive modes such as musharakah, mudarabah, and ijarah. These measures can realign practice with the spirit and objectives of Islamic finance while maintaining operational feasibility in modern banking.

**Keywords:** Tawarruq, Riba, Islamic Banking, Maqasid al-Shariah, Islamic Finance

## INTRODUCTION

The global Islamic finance industry continues to experience significant growth, with assets projected to exceed USD 4 trillion by 2027. This rapid expansion, however, raises a critical question: to what extent do Islamic financial institutions (IFIs) truly adhere to the spirit of Shariah beyond the formal structures of contracts? Evaluating compliance should not be confined to legal form but must also address substance, intent, and long-term socio-economic impact in line with the objectives of Islamic law (maqasid al-shariah).

One of the most widely used yet controversial instruments is tawarruq-based financing, particularly commodity murabahah, which has largely replaced the earlier bay' al-'inah contracts in Malaysia. Tawarruq provides cash liquidity in ways functionally similar to interest-bearing loans in conventional banking. This resemblance raises the central concern: is tawarruq genuinely a legitimate sale contract or a mere legal stratagem (hilah) replicating riba-based lending under a Shariah-compliant façade?

Organised tawarruq (tawarruq munazzam) typically involves a rapid sequence of automated transactions controlled by the bank: purchasing a commodity, selling it on deferred payment to the customer, acting as the customer's agent to resell it, and crediting the cash proceeds. In most cases, customers neither see nor interact with the commodity. Such practices raise doubts about genuine ownership, contractual freedom, and the sincerity

of transaction intent.

The debate thus extends beyond technical fiqh to the philosophical underpinnings of Islamic finance, which emphasize justice (‘adl), transparency (bayan), preservation of wealth (hifz al-mal), and the elimination of exploitation (raf‘ al-haraj). This study aims to critically evaluate the realities of tawarruq practices vis-à-vis conventional riba-based loans, using maqasid al-shariah as the guiding framework.

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## RESULTS AND DISCUSSION

### Structural Parallels between Tawarruq and Riba-Based Lending.

Document analysis reveals that organised tawarruq, while formally structured as a commodity sale, replicates the economic outcome of conventional interest-bearing loans. Customers obtain immediate cash, incur deferred obligations, and often remain unaware of the underlying commodity. This functional equivalence raises doubts about whether tawarruq fulfils the substance of Shariah or merely replicates riba under a different form (Dusuki, 2011; Laldin, 2013).

### Maqasid al-Shariah Assessment.

From a maqasid perspective, tawarruq shows significant limitations. Instead of protecting wealth (*hifz al-mal*), it often increases household indebtedness, sometimes at higher effective costs than conventional loans due to brokerage and administrative fees (Amin et al., 2022). Justice (*‘adl*) is undermined by the lack of transparency, as customers are seldom informed of commodity details, pricing mechanisms, or actual cost structures (Huda et al., 2021). Similarly, the principle of reducing hardship (*raf‘ al-haraj*) is compromised when tawarruq is used predominantly for consumption financing rather than productive investment.

### Issues of Possession, Agency, and Legal Stratagem.

The contracts examined show that commodity ownership is typically nominal rather than real, with no physical delivery to the customer. Banks frequently act both as seller and as the customer’s agent to resell, creating conflicts of interest and limiting contractual freedom. This raises concerns that tawarruq, in practice, becomes a legal stratagem (hilah) that undermines the spirit of genuine trade (Majma‘ al-Fiqh al-Islami, 2009; Usmani,

2007).

**Scholarly Opinions and Institutional Realities.**

Classical jurists such as Ibn Taymiyyah condemned legal devices that permit riba under the guise of trade. Contemporary scholars including Taqi Usmani and Siddiqi argue that organised tawarruq fails to realise the ethical goals of Islamic finance and instead perpetuates debt culture (Siddiqi, 2006; Usmani, 2007). While bodies such as the Shariah Advisory Council of Bank Negara Malaysia allow tawarruq if key conditions are met, critics contend that actual practice often falls short of these standards (BNM, 2019).

**Systemic Risks.**

The over-reliance on tawarruq—sometimes accounting for up to 80% of financing portfolios in certain banks—poses systemic risks to the credibility and innovation of Islamic finance. Such dependence discourages the development of equity-based contracts like musharakah and mudarabah, limiting the industry's ability to differentiate itself meaningfully from conventional finance (Hasan, 2020).

## CONCLUSION

This study shows that although tawarruq fulfils the formal criteria of a sale contract, its organised implementation in modern Islamic banking frequently diverges from the maqasid al-shariah. Structurally, it mirrors the outcomes of interest-based lending, with customers receiving cash in exchange for future debt obligations. Substantively, issues such as nominal ownership, automatic agency, and lack of transparency undermine the objectives of preserving wealth, ensuring fairness, and reducing hardship.

The findings suggest that tawarruq, while legally permissible, risks becoming a legal device that dilutes the distinctiveness of Islamic finance. To realign practice with maqasid, reforms are required: ensuring genuine possession, offering customers independent agency options, enhancing transparency, and encouraging the development of risk-sharing alternatives like musharakah and mudarabah. Such measures are necessary to safeguard the credibility and sustainability of Islamic finance as a truly ethical and Shariah-based system.

## ACKNOWLEDGEMENTS

This work was supported by the Research Fund provided by Universiti Islam Antarabangsa Tuanku Syed Sirajuddin (UniSIRAJ). The author gratefully acknowledges the guidance of colleagues and reviewers who provided constructive feedback during the preparation of this study.

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International Journal of Research and Innovation in Social Science (IJRISS) | ISSN: 2454-6186
DOI: 10.47772/I0JRISS | ICICM 2025 - Conference Proceedings | Volume IX Issue XXIX November 2025

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