International Research Journal of Shariah, Muamalat, and Islam
IRJSMI
EISSN: 2682-8553
Volume 4 Issue 10 (March 2022) PP. 30-45
DOI: 10.35631/IRJSMI.410003

INTERNATIONAL RESEARCH JOURNAL OF SHARIAH, MUAMALAT AND ISLAM (IRJSMI)
www.irjsmi.com

SHARI'AH COMPLIANCE ISSUES IN THE PRACTICES OF *MURABAHAH* FINANCING PRODUCTS OFFERED BY BANKING INSTITUTIONS IN TANZANIA

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Article Info:

Article history:
Received date: 06.01.2022
Revised date: 20.01.2022
Accepted date: 02.02.2022
Published date: 01.03.2022

To cite this document:

Mapeyo, R. S., Othman, A. A., Salleh, S., & Ibrahim, U. (2022). *Shari'ah* Compliance Issues In The Practices Of *Murabahah* Financing Products Offered By Banking Institutions In Tanzania. *International Research of Shariah, Muamalat and Islam, 4* (10), 30-45.

DOI: 10.35631/IRJSMI.410003.

Abstract:

Islamic banking industry in Tanzania began in 2008. Currently, it has several banking institutions with Islamic banking windows and one full-fledged Islamic bank. In this industry, *Murabahah* has been used in most of the financing products. Therefore, this paper discusses and analyses the *Shari'ah* compliant issues in the practices of *Murabahah* financing products offered by banking institutions in Tanzania and proposes the ways forward. The findings of this paper revealed that there are several *Shari'ah* problems such as charging of application fees, use of conventional insurance, uncertainty of agency contract and ownership of the commodity for sale. This happens due to absence of Islamic banking legal and regulatory framework, weaknesses in the banking institutions, and commitment of the people. The methodology adopted in this paper is based on qualitative and descriptive approaches, review, and analysis of authoritative and non-authoritative legal and *Shari'ah* sources, as well as observations. The study recommends for the establishment of Islamic banking legal and regulatory framework, adoption of guidelines for *Murabahah* financing, and enhancement of the *Shari'ah* Boards performance. Moreover, knowledge on the essence of *Shari'ah* compliance should be disseminated to the people, and *Tawarruq* Commodity *Murabahah* financing to meet the need for cash money should be introduced.

Keywords:

Tanzania, Islamic Banking, *Shari'ah* Compliance, *Murabahah* Financing

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Introduction

Islamic banking in Tanzania started in 2008 following approval of the Bank of Tanzania which allowed banks to carry on Islamic banking business (Hikmany & Oseni, 2016). By the end of December 2010, four banks including Kenya Commercial Bank (KCB) (T) Limited, NBC Limited, Stanbic (T) Limited, and the Peoples' Bank of Zanzibar (PBZ) were approved to establish windows for Islamic banking products (Bank of Tanzania, 2011). Currently, the Islamic banking industry is featured by the existence of Islamic banking windows and divisions. Also, there is one full-fledged Islamic bank which is Amana Bank that was established in 2011. Despite the existence of Islamic banking industry in Tanzania for more than a decade, still the industry lacks such an appropriate and suitable legal and regulatory framework (Pradeep & Ali 2018). Consequently, the industry is regulated by the conventional legal and regulatory framework (Omar, Yusoff & Sendaro, 2017). This situation has resulted to the existence of several issues which have impacts to *Shari'ah* compliance (Mzee, 2016).

Since the inception of Islamic banking in Tanzania, *Murabahah* as one of the *Shari'ah* sale-based contracts that secures its legitimacy from the primary sources of the *Shari'ah,* and has been accepted by all schools of Islamic jurisprudence becomes the most popular *Shari'ah* contract used and applied for Islamic banking financing as an alternative to the conventional loan-based products (Kok, 2014). Its application is subject to some modification in order to suit the current practices of Islamic banking and finance, and to cater the needs of the customers who want to subscribe to the *Shari'ah* compliant products.

Therefore, this study discusses and analyses the *Shari'ah* compliance issues in the *Murabahah* financing products offered by banking institutions in Tanzania with a view to propose the ways forward for best practices.

Research Methodology

This study is based on qualitative and descriptive approaches as well as review and analysis of various documentary sources including authoritative and non-authoritative legal and *Shari'ah* sources and field observations on the practices of banking institutions in Tanzania. The reviewed authoritative legal sources involved legislations and case laws. Non-legal and *Shari'ah* sources involved books, journals articles, thesis and reports. Moreover, the study also referred to authoritative Islamic law sources which are the *Quran* and *Sunnah*. In addition, *Shari'ah* standards and rulings issued by international institutions such as AAOIFI were also considered Also, other relevant information were retrieved from online sources.

Field research has also been used in this study for the purposes of collecting relevant information. The field research was conducted on the basis of participatory observation whereby the researcher personally engaged in taking a *Murabahah* financing facility from the banking institution. This facility is for a three years duration commenced from September 2019 to 2022. Moreover, the researcher has been in close contact with people who had also taken *Murabahah* financing facility from the bank for a duration of three years commenced from September 2019 to 2022.

Due to the nature of this study, qualitative data analysis method has been employed. This method has been used to determine the relevancy, validity and correctness of the collected information to ensure that the aims of thie study are achieved. Finally, this is followed by descriptive reporting.

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Nature and Concept of *Murabahah*

To understand the nature of *Murabahah*, two important themes must be known. The first one is "*Ra's al-mal"* which refers to the purchase price or capital invested or used by the person to obtain a commodity for resale. The second one is *"Al-ribh"* which refers an amount of money which is added on top of the purchase price to constitute a profit. Therefore, as discussed by the Muslim jurists including Wahbah Zuhayli and Ibn Qudamah, *Murabahah* refers to a contract of sale in which the seller informs the purchaser about the cost of the commodity *(Ra's al-mal)* and the mark-up profit *(Al-ribh).* Therefore, the purchaser exactly and precisely knows the actual costs incurred by the seller which are related to the acquisition of an object or a commodity for sale, and the profit to be made upon its sale (Zuhayli, 1997). Disclosure of cost of the commodity and the mark-up profit are the salient features which distinguish the contract of *Murabahah* from all other kinds of sale contracts especially *Musawamah*, where ordinarily the customer is completely not aware about the profit to be generated by the seller (Ayub, 2007).

The classical form of *Murabahah* is different from that which is currently being practiced in the modern Islamic banking industry. This form is commonly understood as ordinary *Murabahah.* It is the kind of *Murabahah* in which the seller acquires the goods to be sold under *Murabahah* basis without having any instructions or order from the customer. Currently, in banking practices, the customer approaches the banking or FI and place an order for a certain commodity and promises to purchase once after being acquired. Responding to this, the bank will purchase the requested commodity and sell it in future at cost with a mark-up profit to that customer. This arrangement is commonly known as *Murabahah* by Purchase Order (MPO) (Ayub, 2007). This form of *Murabahah* has been approved under the *Shari'ah* rules. (AAOIFI, Shari'ah Standards No. (8): Murabahah, 2017, s. 2/3). MPO appears to be relevant in banking practices because, normally, it is not in the interest of the bank to purchase items for resale and place them in the warehouse. Moreover, this arrangement leads to convenience as regards to the choices of the customers. It should be noted that, even though as a rule, promises are not legally binding under the *Shari'ah,* but a promise made in the arrangement for MPO is legally binding and enforceable (Obaidullah, 2005). The essence of making a promise to be enforceable is to protect the banking or FI from collapsing, and to safeguard public interests.

The arrangement for MPO ordinarily is attached with the creation of an agency relationship between the banking or FI and the customer for the acquisition of a commodity. Upon creation of this relationship, the customer will acquire a commodity on behalf of the FI which will later be sold to him on *Murabahah* basis (Hassan et. al, 2016). This arrangement under the *Shari'ah* is known as *Wakalah*. *Wakalah* refers to a contract of agency, whereby one person acts as a principal and appoints another person as an agent to act on his behalf. Upon conclusion of the *Wakalah* contract, provided that an agent acted within the scope of his authority, all acts done by him, bind the principal against third parties. According to Al-Fawzan, *Wakalah* is an act in which a person who is legally accountable appoints another person who is also legally accountable to act on his behalf for certain matters which are legally permissible (Al-Fawzan, 2005). The definition of Al-Fawzan emphasises on two aspects which are legal capacity of the parties to *Wakalah* contract, and the legality of the subject matter for that contract. Therefore, failure in either aspect of the two, invalidates the contract. In the application of *Murabahah* financing, it is crucial for *Wakalah* to be properly arranged and concluded in accordance with the *Shari'ah* so as avoid faults leading to the future *Murabahah* sale not to be valid. In practice, MPO is also attached with a binding promise. This is a unilateral promise which is made by the customer who commits and binds himself that he will purchase the commodity once after

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IRJSMI
EISSN: 2682-8553
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being acquired by the financier (Usman, 2002; Obaidullah, 2005). And finally, a *Murabahah* contract between the customer and the FI will be concluded once after a commodity has been acquired and ownership has been passed to the FI. And this will be followed by repayment of the selling price by the customer on deferred basis.

Although the practice of MPO has received wide acceptance and approval, it has not been free from criticisms. Several arguments against it, have been raised. Some of the arguments include the time value of money which is related to interest-based loan, existence of a unilateral binding promise, and avoidance of risk relating to ownership and possession of a sale object by involving arrangements such as agency, earnest money, and insurance (Guney, 2015). In Tanzania also, some people have questioned the *Shari'ah* legitimacy of *Murabahah* financing practices. Some people argue that *Murabahah* is as good as conventional loan because they do not believe on the existence of a true sale (Moh'd &Rose, 2019).

Essential Rules and Conditions of Murabahah Sale

The *Shari'ah* requires that for a sale to be valid, firstly, the subject matter for a sale must be in existence at the time of concluding a sale. However, this condition is not necessary in *Istisna* and *Salam* contracts (El-Gamal, 2006). Al-Fawzan has quoted Al-Wazir saying that, scholars have agreed that it is impermissible under the *Shari'ah* for a person to sale an item which is not existing, or that which he does not possess, or conclude a sale first and later goes to the market to buy such an item to be delivered to the customer in future (Al-Fawzan, 2005). Secondly, the subject matter for the sale must be lawful. Selling of prohibited items such as wine and pork is prohibited. The subject matter must also be capable of being determined in terms of nature quality and quantity (Alam et al, 2017). In the determination of nature and quality of the subject matter, the seller should let the purchaser knows about any existing defects. And, if there are defects to the subject matter of a contract which cannot be perceived by senses, a seller is duty bound to disclose them to the purchaser. A failure to do so, entitles the other party, the right to rescind the contract (Othman, 2014). However, if the purchaser is informed about the existing defects and accepts the sale, he is prevented under the *Shari'ah* to deny the contract in future. Thirdly, the seller must be the owner of the object of sale. The great Imams Shafi'i and Ahmad regard ownership as a necessary condition for the conclusion of a sale contract (El-Gamal, 2006). As regard to ownership of the subject matter of sale, it is reported that Prophet told Hakim Ibn Hizam that,

> *"Do not sale what you do not have"* (Abu Dawud (3505) [3/495] and At-Tirmidhi (1235) [3/534]

However, a sale by an agent is deemed as valid provided that such an agent has been authorized by the owner to conclude such a sale contract (Al-Fawzan, 2005). Though, it is not necessary for ownership and possession to be physical, having a constructive possession is enough to conclude a valid sale (Usman, 2002). A person is said to have a constructive possession over the commodity if he or she has the control over the commodity, and that all rights and liabilities attached to it, including the risk of destruction, have passed to him (Usman, 2002). Fourthly, the selling price, mode and duration of payment must be known to the parties. Failure to do so may lead to uncertainty *(Gharar)* and renders the contract to be void. Basically, the price can be determined in lump sum basis or by way of percentage, and it can be paid on the spot, or in a future time (Zuhayli, 1995). Moreover, the duration and mode of delivery of the sold item must be determined and be made clear and certain. It is not permitted to create any circumstance which would make delivery of the commodity to be on contingency or chances (Usman, 2002). Furthermore, the parties must have the legal capacity to contract. Capacity to contract in this

International Research Journal of Shariah, Muamalat, and Islam
IRJSMI
EISSN: 2682-8553
Volume 4 Issue 10 (March 2022) PP. 30-45
DOI: 10.35631/IRJSMI.410003
case entails age of maturity and mental fitness. The issue of legal capacity has a solid proof within the Quran in the following verses.

> *"And try (the orphans as regard their intelligence) until they reach age of marriage; if then you find sound judgment in their mind, release their property to them…"* (An-Nisaa: 6)

The Quran in another verse says,

> *"And give not to the foolish your property which Allah has made a means of support for you…"* (An-Nisaa: 5)

In these two above verses, Allah directs us the way to handle and deal with wealth or property belonging to the minor and people who do not have sound judgment. The essence of this directive is to protect the interests of these categories of people, and this is basically related to the rationale behind legal capacity in contractual arrangements.

In addition to the general requirements pertaining to sale contracts, a *Murabahah* must also meet other specific requirements. The first one is about disclosure of the cost of goods and the mark-up profit. In this case, it operates as a trust sale which binds the seller to be honest in letting the purchase to know exactly as to how much cost the seller acquired the item for sale, and what profit will be generated in the sale. If the seller deceives the purchaser in this case, the *Murabahah* turns to be void (Zuhayli, 1995). Another important requirement is that an object of sale in a *Murabahah* contract should not involve *Ribawi* items (Hassan et al., 2016). *Ribawi* items refers to the goods which are subjected to the rules relating to interest *(Riba)* when they are to be involved in trade and exchange. *Ribawi* items are of two categories which are commodities and medium of exchange. The category of commodities includes foods stuffs such as wheat, barley, rice, and other related varieties. The category of medium of exchange includes gold and silver, as well as money currency (Alam et al, 2017). All these *Ribawi* items cannot be traded in *Murabahah* sale because exchange of these items must be done in equal value, thus the mark-up profit cannot be added as it is supposed to be done, since it will result into interest. And lastly, its crucial for the original sale to be valid so as the second sale in *Murabahah* to be valid. This is because the second sale is determined basing on the original sale as regard to the nature of the subject matter, cost of goods and determination of the selling price with the profit margin (Zuhayli, 1995).

Shari'ah Proof of Murabahah

The Quran which is first principal source of the *Shari'ah* is very clear regarding the permissibility of trade, selling and purchase. It says,

> *"…Allah has permitted sale, and prohibited Riba…"* (Al-Baqarah: 275)

Therefore, according to the above verse all forms of sale are deemed permissible unless such a sale involves prohibited items, or it has been made or concluded in violation of the general rules and norms of the *Shari'ah* and its contractual requirements. This position is applicable to justify the application of *Murabahah.*

According to Al-Kaff, the early Muslim jurists relied upon the secondary sources of the *Shari'ah* to justify the validity of *Murabahah* as there are no evidence from the principal sources which specifically refers to it (Al-Kaff, 1986). The practice of *Murabahah* is regarded to be permissible in all four major *Sunnih* Schools *(Madh-hab)* of Islamic jurisprudence *(Fiqh).* Imam Malik approved the application of *Murabahah* basing on the custom (*Urf*) of the people

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EISSN: 2682-8553
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of Medina who used to practice it. He is of the view that it is permissible for a person to go and purchase a piece of a cloth from a town and go to sell it in another with an addition of an amount of money as a profit (Al-Kaff, 1986). Likewise, Imam Shafi'i holds a view that, it is permissible for a person to request another person to purchase a certain commodity so that he may purchase it from him in future with an addition of amount of money as a profit (Shafi'i, 1321 A.H). This kind of arrangement relates to what is being done in the *Murabahah* sale. Such a view of Imam Shafi'i is supported by Imam Nawawi who is one among the eminent jurists in the Shafi'i *Madh-hab* (Howard, 1914). Moreover, (Badr al-Din al-Ayn, 1990) and (Ibn Humam, 2003) who are the Hanafi jurists have validated the practice of *Murabahah* basing on the ground that it fulfils all the requirements of a valid sale under the *Shari'ah*.

Moreover, the contemporary scholars have also accepted the practice of *Murabahah*. In 1988, the International Islamic Fiqh Academy of the Organization of Islamic Conference (OIC) in its resolutions (No. 40-41), approved the application of *Murabahah* in banking and financing, and inclusion of a binding promise which is made by the purchaser (International Islamic Fiqh Academy, 2021). In 2000, the *Shari'ah* Board of the AAOIFI also passed a resolution to adopt the *Shari'ah* Standards for *Murabahah* (AAOIFI, 2015). And, in 2002 the *Shari'ah* Board of the AAOIFI, readopted its resolution to reformat the *Shari'ah* rules of *Murabahah* in the form of *Sharia'h* Standards (AAOIFI, 2015).

Murabahah Financing Products Offered by Banking Institutions in Tanzania

In Tanzania, the Muslim community has been facing a challenge to secure potential economic and commercial opportunities which are usury free (Sulayman, 2015). This is because, Muslims are required under the *Shari'ah* to avoid all forms of prohibitions, and this could not be easy due to lack of sufficient Islamic banking and financing products and services to meet their demands for consumer use and business purposes. Considering the demand for financing in Tanzania in one hand, and the obligation imposed upon the Muslim community to comply with the rules of the *Shari'ah* on the other hand, banking institutions opted to come up with various financing instruments which will not only satisfy the demands of the customers, but also ensuring *Shari'ah* compliance. One of the developed instruments is *Murabahah* financing-based product.

Most of the M*urabahah*-based financing products in Tanzania which are currently offered by different banking institutions are almost similar. Though they come up with different names or brands. The NBC Bank limited offers its *Shari'ah* compliant products on *Murabahah* basis going with "La Riba" as its brand (NBC Bank Limited, n.d.). The first category is "La Riba Personal Group Finance" in which the bank finances the acquisition of building or construction material, electronic equipment, household items, and other valuable assets requested by the customer. For this product, the bank requires neither deposit nor security (NBC Bank Limited, n.d.). The second category is "La Riba Business Finance and Wakalah LC" which is designed for the purposes of financing trading and business activities. In this product, the bank purchases for resale, various merchandise goods such as machinery, or raw materials needed for industrial production (NBC Bank Limited, n.d.). On the other hand, Amana Bank Limited offers several financing products on *Murabahah* basis including Working Capital Financing, Plot Financing, Consumer Financing, Asset Based Financing, and Solidarity Group Financing (Amana Bank, n.d.). The Working Capital Financing is the financing product which involves sale of finished and raw materials which is offered only to business entities. The customer is availed with a duration of repayment on determined instalment for an agreed duration. To secure this product, a customer will be required to provide collateral or security (Amana Bank, n.d.)The Plot

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EISSN: 2682-8553
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Financing product has been designed to avail customers to acquire and own land. The Asset based Financing products has been designed only for manufacturing entities to enable them to obtain plant as well as machinery and equipment (Amana Bank, n.d.). Solidarity Group Financing products is devised to meet the demands of small entrepreneurs in both formal and informal sectors for working capital, assets as well other (Amana Bank, n.d.). Moreover, the Peoples' Bank of Zanzibar also offers several products on *Murabahah* basis. The products are available for consumer as well as business uses. These product avail people with an opportunity to acquire and own assets both movables and immovable, equipment, working capital, motor vehicles, and machinery (Mzee, 2021) Similarly, the Kenya Commercial Bank (KCB) (T) Limited also offers *Murabahah*-based financing for consumer use, as well as trading and business purposes (KCB Bank, n.d.).

In practice, depending on the category of *Murabahah*- based financing products, a customer may or may not be required to provide security or collateral or guarantee. Also, customers may or may not be required to provide an advance deposit. As regard to the repayment, normally, the repayment duration can be for a period between one year to five years depending on the agreement of the parties, and this goes with a repayment rate of between 10 to 14 percent per annum (Mzee, 2021). Though, a customer is not prevented to complete the repayment before the maturity of the credit facility. Moreover, in the event when a customer defaults to repay as per the repayment schedule, a penalty can be imposed, and this does not form part of income of the banking or financial institution. The collected income from penalties, normally is used for charitable purposes to avoid occasion of interest practices and *Shari'ah* compliance problems (Amana Bank, n.d.). Furthermore, as regards to issues of recovery upon non completion of repayment until maturity of the credit facility, banking institutions have been using Courts of laws to remedy the breach and/or selling of an asset pledged as a security. (See the case of *Amana Bank Limited v Shaban Athumani Mshana and 3 Others* (Commercial Case No. 124 of 2014, High Court of Tanzania Commercial Division at Dar es Salaam (Unreported)); and the case of *Amana Bank Limited v. Paulina Agustino Mwanga* (Civil Appeal No. 36 of 2018, High Court of Tanzania (Dar es Salaam District Registry) at Dar es Salaam (Unreported).

Shari'ah Compliance Issues in the *Murabahah* Financing Practices in Tanzania

Shari'ah compliance in Islamic banking is a crucial issue. That is why there are *Shari'ah* governance models and systems to ensure compliance. In some countries such as Malaysia, there is a central *Shari'ah* supervision system for Islamic financial business (Bello & Zubaedy, 2015). Basically, Malaysia has such a well designated legal and regulatory framework for Islamic banking business (Mat Ali, Hassan & Othman, 2018), and there are specific guidelines for *Murabahah* financing practices. On the other hand, despite the existence of Islamic banking business for more than a decade in Tanzania, still the country has no legal and regulatory framework to govern that business (Pradeep & Ali, 2018). And there is no even single guideline for *Murabahah* financing practices. Thus, the issue of full *Shari'ah* compliance has remained to be a challenge (Chalu, 2014). At present there are several *Shari'ah* compliance issues in the *Murabahah* financing practices within the country. The issues include charging of application and negotiation fee, application of conventional insurance, uncertainty of agency contract, problems in ownership of a commodity before conclusion of a *Murabahah* sale, conclusion of a *Murabahah* sale contract, collection of cash money instead of commodity, dealing with defaulting penalty, and challenges relating to restructuring.

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EISSN: 2682-8553
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Charging of Application and Negotiation Fee

Charging of service fees in *Murabahah* financing products such as application and negotiation fees has attracted reactions on *Shari'ah* legitimacy and validity of the practices. It has been argued that *Murabahah* is as good as conventional loan because of these fees. It is claimed that *Murabahah* and conventional loan is just the same thing, and the only difference between the two, is just the names (Ahmad 2007). The AAOFI Shari'ah standards neither permit charging of commitment fees nor imposition of fees for credit facility in *Murabahah* financing (AAOFI, Shari'ah Standards, No. (8) Murabahah, 2017, s. 2/4/1 & s.2/4/2). Though, this is the position of the *Shari'ah*, observation which has been made in the practices of banking institutions in Tanzania has revealed that there is a tendency of charging and collecting credit facility fees in *Murabahah,* such as negotiation fees, an act which is contrary to the AAOIFI *Shari'ah* standards. Thus, there is a need to have clear guidelines for *Murabahah* financing which can regulate the practices of the banking institutions to ensure *Shari'ah* compliance. The guidelines should have a binding legal effect for effective positive outcomes.

Application of Conventional Insurance

In practice, credit facilities or loans offered by banks in Tanzania are covered by insurance or underwriting policies. This is a mandatory requirement of the regulator of banking business which is the Bank of Tanzania. *Murabahah* financing being a credit facility is also supposed to be covered as well (Suddy, 2021). However, the existing challenge is that conventional insurance is not approved under the *Shari'ah*. Presence of elements of interest *(Riba),* uncertainty *(Gharar)* and gambling *(Maysir)* are the reasons behind *Shari'ah* disapproval of conventional insurance (Obaidullah, 2005). Alternatively, the practices of *Murabahah* financing could use Islamic insurance *(Takaful)* for that purpose. However, this option cannot work because there is no *Takaful* in Tanzania (Awadh, 2022). Absence of *Takaful* and existence of a mandatory requirement of insurance in *Murabahah* financing open the doors for the application of *Shari'ah* principles relating to necessity and hardship. The principles provide that in case of hardship or under the condition of necessity, the *Shari'ah* rules can be relaxed to allow using of prohibited items (Al-Mutairi, 1997). Therefore, under this prevailing situation, application of conventional insurance does not affect the *Shari'ah* legitimacy of the *Murabahah* financing practices. Though, there is a need to establish *Takaful* to ensure proper *Shari'ah* compliance practices.

Uncertainty of Agency Contract

One of the essential norms of the *Shari'ah* relating to commercial arrangement is the avoidance of elements of uncertainty in the making of contracts (Hassan et al, 2016). To eliminate or avoid the occasion of the problem of uncertainty, among other things, terms of the contract must be clearly understood by the parties (Hassan et al, 2016). Now regarding the *Wakalah* contract, its important aspect is the relationship between the principal and agent, whereby each party must be aware of his rights and obligations under that relationship. The procedural practices of some banks in Tanzania reveal that there is a stage where an agency contract is executed between the bank and the customer for acquisition of an asset (Mzee, 2021). However, it has also been observed on the other hand that there are problems in the existence of the agency contract. Basically, the *Shari'ah* requires that there must a duly executed agency contract appointing the customer as an agent of the bank for acquisition of an asset (AAOFI, Shari'ah Standards, No. (8) Murabahah, 2017, s. 3/1/5). Basing on this contract, the customer will approach the supplier to place an order for purchasing the commodity and send the documents to the bank for satisfaction of the payment of the purchase price. It should also be noted that the rules of *Shari'ah* require that the payment should be made directly to the supplier

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IRJSMI
EISSN: 2682-8553
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and not to the customer (AAOFI, Shari'ah Standards, No. (8) Murabahah, 2017, s. 3/1/4(a)). The problems which exist in the banking practices in Tanzania is whether the customer acts on behalf of the bank or for himself when he is dealing with the supplier. Let us consider this scenario, a customer approaches the bank for car financing on *Murabahah* basis. Then, the bank appoints the customer as its agent. The customer then approaches the seller and executes the contract on his name ad with a price which is unknown to the bank. This happens in such a way that a customer negotiates the lower price and presents to the bank a different price which is higher. Once a bank pays the supplier, the customer will collect the car and the remaining balance of the purchase price. In this scenario, there is a problem in the agency contract, and basing on this position the act of appointing customer as agents of the financier should be considered cautiously to avoid *Shari'ah* compliance problems.

Ownership of a Commodity

The rules of the *Shari'ah* requires the seller to own and possess the subject matter for sale before conclusion of a sale contract. Otherwise, such a contract cannot be valid (Sadique, 2018). Ownership and possession of a subject matter for sale can either be physical or constructive (Shaikh, 2011). In practice, Bank or FI appoints customers to be an agent for the purposes of engaging with the supplier to secure and obtain ownership of an asset. This practice is acceptable under the rules of the *Shari'ah* (AAOIFI, Shari'ah Standards No. (8): Murabahah, 2017, s. 3/1/3 and 3/1/4). When a customer approaches the vendor or supplier for the purposes of purchasing the commodity, it is important that, he should understand that he is acting on behalf of the FI and not for himself. This is because, ownership of the commodity must be transferred to the FI before it can pass to the customer. If ownership directly passes to the customer, there shall be no *Murabahah* sale between the customer and the FI because the later cannot sell an item which it does not own and possess. Basically, the above discussion on the issue of agency contract shows that there are problems in as far as transfer of ownership and possession of the commodity is concerned. It has been discussed that the existence of a *Wakalah* contract between the customer and the FI is to a large extent uncertain. Similarly, it is also uncertain whether ownership and possession of the commodity passes to the FI before moving to the customer. This is because it happens sometimes, a customer purchases the commodity under his name (Personal Communication, October 18, 2019). The only thing which makes a difference is that the FI pays the money to the vendor or supplier. But this does not *per se* justify transfer of ownership from the vendor to the FI. Generally, the problems of uncertainty on ownership significantly affects *Shari'ah* legitimacy and compliance of the *Murabahah* financing practices.

Conclusion of Murabahah

Murabahah is the main component in the arrangement of *Murabahah* financing. This is the phase or stage in which a sale contract between the FI and the customer is concluded. This stage is necessary for the transfer of title from the seller to the purchaser. Basically, offer and acceptance are necessary in the conclusion of any kind of sale contract (El-Gamal, 2006). Hanafi and Malikis consider that a sale contract is concluded and becomes binding between the parties following the making of an offer and proposal (El-Gamal, 2006). Though, Shafi's and Hanbalis are of the opinion that the parties still retain the right to rescind the contract if the contract session is still on, and this right ends upon expiry of such a session (El-Gamal, 2006). Thus, conclusion of a *Murabahah* requires an offer of sale which indicates and discloses the selling price which involves cost of the goods or assets and the profit margin along with other operational terms and conditions. If the customer agrees with the terms of an offer, he or she will accept the offer in clear and unequivocal terms by signing the contract. It is important to

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note that the financial institution is not supposed to conclude a *Murabahah* with a customer before acquiring ownership of an asset. If this happens, then the whole *Murabahah* financing arrangement becomes invalid under the *Shari'ah.*

In practice, banking institutions have been doing *Murabahah* financing in accordance with the *Shari'ah*. Though, to a certain exchange there are problems of *Shari'ah* compliance in this aspect of conclusion of a *Murabahah* contract. This is because occasionally the contract is not properly concluded. Banking institutions have been erroneously considering the signing and acceptance of a sale invoice by the customer as a conclusion of *Murabahah*. This is because such an invoice merely indicates an offer of sale from the supplier to the banking institution. Thus, if it is accepted, it signifies an acceptance of the sale by the banking institution and not the customer. Moreover, with such a sale invoice at its hands, the bank is supposed to first make payment to the supplier so that title and ownership can move to its side. Then, after that a sale contract between the bank and the customer can be properly done. Therefore, it is significant for the *Shari'ah* supervisory bodies within the financial institutions to observe the *Murabahah* transactions to ensure *Shari'ah* compliance practices.

Collection of Cash Money

In *Murabahah* financing transaction, the bank or FI sells the asset or commodity and make profit out of the sale. In this transaction, a customer is not given cash to avoid engaging in prohibited interest-based loans. Though in practice, there is a challenge of collusion between the customer and supplier which enables the customer to obtain cash illegally. What happens is that a customer approaches the bank for financing on *Murabahah* basis. The customer is then appointed as an agent of the bank for the acquisition of a commodity. The bank upon receiving information from the customer, pays the supplier of the commodity. Upon receipt of the payment by the supplier, the customer approaches him to collect cash money instead of the commodity (Moh'd & Abdulla 2019). If the customer colludes and takes cash instead of the commodity, under this circumstance there is no sale under *Murabahah*. The cash taken resembles to loan, hence the mark-up profit, which is to be paid in future, amounts to interest *(Riba)*. Thus, the purpose of involving a commodity which is to avoid the occasion of interest is defeated.

In the event of collusion who is to be blamed, the FI or the customer? The answer is not direct to the side of the FI but direct to the customer. The customer who does such an act commits fraud, and this is contrary to the *Shari'ah,* and it is sinful and punishable in the sight of the Almighty God. In the Quran, Allah the Almighty commands the believers to observe and honour their contractual obligation. The Quran says,

> *"O, you who believe! Fulfil (your) obligations…"* (Al-Maidah: 1).

The FI on the other may not be blamed in the event of collusion if it has properly followed all the procedures in the making of *Murabahah* financing arrangement. The important procedures here include properly setting and making of an agency contract for acquisition of a commodity, ensuring transfer of ownership from the vendor or supplier to the FI, and finally concluding a *Murabahah* transaction. If we carefully look on the AAOIFI *Shari'ah* standards, it has been clearly observed that even though it is permissible for a customer to be appointed as agent for the acquisition of a commodity, it is highly discouraged. The rules prefer that a customer should not be appointed as agent for that purpose unless there is a dire need (AAOIFI Shari'ah

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Standards No. (8): Murabahah, 2017, s. 3/1/3). And for the avoidance of doubts, the rules require the liability and risk attached to the commodity, must be separated between the liability of a customer as an agent, and the liability of FI (AAOIFI Shari'ah Standards No. (8): Murabahah, 2017, s. 3/1/5). Moreover, the rules direct that if a customer is appointed as an agent, the payment by the FI must be done directly to the vendor or supplier and not him, and the FI must ensure that it obtains documents to authenticate the occurrence and conclusion of a sale between the customer as agent and the vendor (AAOIFI Shari'ah Standards No. (8): Murabahah, 2017, s. 3/1/4). The essence of the procedure is to avoid problems of collusion, and to ensure that there is a true transaction, and that the FI obtains ownership of the commodity before it can proceed with the *Murabahah* contract in future with the customer.

Looking from the other perspective, *Tawarruq* Commodity *Murabahah* could be used by the bank as the best way to satisfy the needs of customers who seek to obtain cash and to avoid the *Shari'ah* compliance problem of collusion. This form of *Murabahah* enables the bank to provide cash financing because it is a tripartite sale. In operation, a bank approaches the bank seeking to obtain cash money. If the bank agrees, then a *Tawarruq Commodity Murabahah* is arranged. This arrangement will involve three sale contracts (Obaidullah, 2005). The first sale contract will be for the acquisition of an asset from the supplier between the bank and the supplier, and in this sale, a customer will represent the bank as its agent to conclude a sale contract. The second sale contract will be the *Murabahah* sale between the bank as the seller and the customer as the purchaser on deferred basis. And the third sale will be on cash basis between the customer and any other entity or person, and the bank will act as agent of the customer. This last sale will enable the customer to obtain cash which will be deposited or channelled in his or her bank account to meet his or her demand for cash (Hassan et al, 2016).

Defaulting Penalty

If a person fails to repay a loan as provided in the credit facility agreement, banking institutions normally impose and collect a monetary penalty. Normally, conventional banks consider and treat the collected money as their income. In the practices of Islamic banking and finance, the issue of imposing defaulting penalty has raised conflicting opinions among Muslim scholars. But before looking to those conflicting opinions, it is worth to highlight some few issues. Firstly, a debtor has the duty to honour his or her obligation as agreed under the contract. This duty is sanctioned under the Holy Quran. The Quran says,

> *"O! You who believe! Fulfil your obligations…"* (Al-Maidah, 1)

Basically, among the obligation of a debtor is to repay the debt accordingly as agreed in the contract between him and the creditor. Prophet Muhammad (Peace Be Upon Him) has stressed on this obligation in the *hadith* narrated by Abu Hurairah in which he says,

> *"Procrastination (delay) in paying the debts by a wealthy person is injustice…"* (Sahih Bukhari, Vol. 3, Book 38. No. 2287).

However, the Quran has not left to address the position of a debtor who is in distress condition. This is a debtor who has not been able to repay his debt due to genuine reasons beyond his or capability and control. In this case the Quran provides options including giving relief in terms of extension of time for repayment until when he or she will be able to do so or relinquishing the debt as charity. The Quran says,

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> *"And if the debtor is in hard time (has no money), then grant him the time till it is easy for him to repay, but if you remit it by way of charity, that is better for you if you did know."* (Al-Baqarah: 280)

Now turning to the conflicting opinion about charging of penalty to defaulting debtor in the practices of Islamic financing. Basically, there are three different opinions. The first opinion is held and supported by the leading contemporary scholars in Islamic finance including among others, Mustafa al-Zarqa and Muhammad Sadiq al-Dharir. This opinion is also supported by the Shari'ah Council of the Jordan Islamic Bank and the Shari'ah Advisory Council (SAC) of the Central Bank of Malaysia. According to this opinion, imposition of penalty is allowed on the basis of *Maslahah Mursalah* and it can benefit the financial institution as its income (Yaakub et al, 2014). Though, as per the resolution of the SAC the Central Bank of Malaysia charges imposed for late payment are categorized into two types which are *Ta'widh* (compensation) and *Gharamah* (penalty) (Yaakub et al, 2014). In the practices of *Murabahah* financing, the parties may agree to include a term in the contract for *Ta'widh* and *Gharamah* for late payment (Bank Negara Malaysia, 2013). Basically, *Ta'widh* refers to a compensation for actual loss suffered by the seller and this can be regarded as in income of the seller. On other hand, *Gharamah* which is a penalty, is supposed to be used for charitable purposes and cannot be considered as income of the seller (Bank Negara Malaysia, 2013). According to the second opinion, imposition of penalty is allowed, Though the collected income should be used for charitable purposes only and should not be treated as income of the financial institution. This is the position of the Shari'ah Board of Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI) (Yaakub et al, 2014). The essence of disallowing the collected monetary penalty to be part of income of the financial institution is to avoid occasion of prohibited interest *(Riba)*. Moreover, according to the third opinion, penalty should not be imposed at all. This is the opinion of Nazih Hammad, a member of the Islamic Fiqh Academy of the OIC and it is supported by Mohammed Ali Algari, a Professor of Islamic Economic in Saudi Arabia (Yaakub et al, 2014). Though, generally, the position of the Islamic Fiqh Academy of the OIC is in favour of charging penalty (Zulkipli, 2020). Imposition of penalty is justified on several grounds including that late payment leads to harm to the creditor, it is also a form of devouring the benefit of other persons property unjustly, and that penalty is the best remedy in financial matters (Muneeza et al, 2019).

Now moving to the *Murabahah* financing practices in Tanzania. Basically, banking institutions have adopted the second opinion which permits charging of defaulting penalty, though the collected income is to be used for charitable purposes. Apart from this, there are some issues which have been observed which are related to imposition of defaulting penalty. One of the issues is charging of penalty without due regard to genuine hardship. For instance, some of the banking institutions have been collecting the penalty even from the customers who were unable to repay due to genuine reasons such as not being paid their salaries by the employers, and whereby the salary is the only source of income which they have. This practice is against the general objectives (*Maqasid)* of the *Shari'ah* and need to be reconsidered.

Rescheduling

In practice, a during a conclusion of a *Murabahah* sale contract, a repayment schedule will be set. This schedule normally indicates the whole duration of a financing facility and the amount of repayment in each instalment along with the specific time for the repayment. The signed contract binds the customer to repay as provided under the schedule, failure to do so will entitle the bank to impose penalty for default. It may happen for good reason that the parties wish to

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restructure the credit facility and substitute the repayment schedule. And this normally happens in practice. The rules of the *Shari'ah* allow restructuring of the credit facility in *Murabahah* financing practices. However, there are issues to be considered to avoid occasion of prohibited interest. Thus, restructuring is allowed for whatever period according to the wishes of the parties to the contract. However, such an act should not be accompanied with addition of the selling price or charging of additional payment. Restructuring or rescheduling must be made with the same amount of the selling price and same currency. Contrary to this, it is forbidden (Usmani, 2002). This position is provided under the AAOIFI Shari'ah standards (AAOIFI, Shari'ah Standards, No. (8): Murabahah, 2017, s. 5/7). However, compliance to this *Shari'ah* requirements is a challenge in Tanzania. This is because the Bank of Tanzania requires additional amount to be charged for restructuring of loans or credit facility offered by the banks as observed in the case of *Amana Bank Limited v Shaban Athumani Mshana and 3 Others (Supra).* In this case, the parties had agreed to restructure the *Murabahah* facility agreement, and it was done with an addition of a ten percent of the credit facility amount. Therefore, for the purposes of ensuring *Shari'ah* compliance, there is a need to have specific rules and guidelines which have the force of law to regulate the operation of *Murabahah* financing transactions in Tanzania.

Conclusion

It has been observed that there are several *Shari'ah* compliant issues in the practices of *Murabahah* financing in Tanzania. Generally, these issues can be associated with the absence of legal and regulatory framework for Islamic banking in the country in one hand. And on the other hand, lack of knowledge on the essence of compliance to *Shari'ah* requirements to the people, contributes to *Shari'ah* compliant problems such as collusion between customers and suppliers to avoid the commodity and collect cash money in *Murabahah* financing. The other reason for non-compliance is related to the banking institutions themselves for things which have nothing to do with absence of legal and regulatory framework. For instance, the issue of ensuring proper formation of agency contracts and conclusion of *Murabahah* transaction fall within the capability of the banking institutions. Thus, it is recommended that institutional S*hari'ah* Boards should be keen to ensure *Shari'ah* compliance.

Basically, the *Shari'ah* compliant issues which have been observed include charging of fee such as application and negotiation fees, an act which is contrary to the AAOIFI *Shari'ah* standards. Another issue is application of conventional insurance. Though, due to circumstances of necessity, this act does not invalidate the *Murabahah* financing transaction, but there is a need to establish *Takaful* to support Islamic banking practices. An appeal is made to the regulator to bring the regulations for *Takaful* business to commence within the country. Other issues are uncertainty of agency contract and ownership of a commodity for sale. It has been observed that the arrangement of agency contract between the banking or financial institution occasionally appears to have problems in meeting the *Shari'ah* requirements. This affects transfer and passing of ownership from the supplier to the banking institution for the purposes of concluding a *Murabahah* transaction. It is therefore recommended that banking and financial institution should ensure that *Shari'ah* requirements in making the agency contracts are met. Institutional *Shari'ah* Boards should be keen to consider this aspect for want of *Shari'ah* compliance. Another issue is improper conclusion of a *Murabahah transaction.* This also needs the attention of the banking institutions and the institutional *Shari'ah* Boards. The other problem is collection of cash money which is somehow complicated to handle. It is recommended to educate customers on the essence of involving a commodity which is to avoid prohibited interest. Alternatively, banking institutions may opt to offer cash financing through

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Tawarruq Commodity *Murabahah* to customers who need cash money. Moreover, imposition of penalty for defaulting is also having problems because even customers who delay for genuine reasons are subjected to penalty, and this is contrary to the ultimate objectives *(Maqasid)* of the *Shari'ah.* This also is supposed to be reconsidered. The last issue is restructuring or rescheduling. The *Shari'ah* allows rescheduling though no addition of money should be fixed. But this cannot be done because the regulator of banking business in the country requires additional amount to be imposed for restructuring. Generally, it is recommended to have the legal and regulatory framework for Islamic banking business in the country. This will assist to contradiction in regulatory issues and ensure *Shari'ah* compliant practices.

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