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**Distinguishing Features of  
“Fake” and “Real” Contracts  
Comparative study of the Shari’ah and law**

**Annual Shari’ah Conference**

**Accounting and Auditing Organization for  
Islamic Financial Institutions**

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## Fake contract – wrong perception

- Common perception - fake contract means defective contract
  - missing offer, acceptance, ownership or possession like fake gold
- Often the following phrase is used to refute faking
  - العقد مكتمل للشروط و خالي من العيوب المعتبرة شرعا و منفصل
- In Shari'ah a defective contract is called
- A fake contract is referred to as التحايل او الحيلة
- This comparative analysis will show that both, the principles of the Shari'ah and law, in dealing with the issue of fake contracts, emphasize the substance, intention and purpose and not the appearance (صورية) and technical formalities of the contracts

## Valid contract - illegal purpose

- Most fake contracts are technically sound contracts – but used with bad intentions and objectives
- Intentions and objectives can be deducted using evidence – including circumstantial evidence; parties, sequence etc.
- Faking is a universal and historical problem
- Faking comes in many forms
  - Lying, fake argument, adding conditions to a contract which are contrary to its purpose (هبة بشرط العوض), combining several legally valid contracts to reach an illegal goal
- Common characteristics: complex, structured and dressed up in order to hide the truth ( )

## Shari'ah principles and guidance

و لا تلبسوا الحق بالباطل و تكتموا الحق و انتم تعلمون  
إنما الأعمال بالنيات و إنما لكل امرئ ما نوى  
الأمور بمقاصدها

• العبرة في العقود للمقاصد و المعاني لا للالفاظ و المباني (الهبة بشرط العوض بيع - تجري فيها الشفعة)

نهى النبي (ص) عن بيعتين في بيعة، وعن سلف وبيع و صفقتين في صفقة (سدا للذريعة)  
إنكم تختصمون إلي ولعل بعضكم ألحن بحجته من بعض، فمن قضيت له بحق أ.  
بقوله فإنما أقطع له قطعة من النار، فلا يأخذها

• لو يعطى الناس بدعواهم، لادعى رجال أموال قوم ودماءهم، لكن البينة على المدعي واليمين على من أنكر

• جلست في بيت أبيك وأمك حتى أتيتك هديتك إن كنت صادقاً

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## Modern Judicial Doctrines

- 5 judicial doctrines used by courts to distinguish between a genuine and a fake use of contracts and structures
- Example from a tax perspective
- Observe the similarity between Shari'ah guidance and modern human judicial development
- Observe the emphasis in both - the original sources of the Shari'ah and law is on purpose, intention, truth and transparency
- The emphasis is not on choosing labels, dressing up, legal technicalities and legal constructions

## 1- Sham transaction doctrine

- The benefit derived from a transaction which did not actually occur
- The law requires that, in order to be recognized, a land sale contract must be recorded and registered, parties enter into a land sale contract, but do not register it

## 2 – Economic substance doctrine

- The doctrine of economic substance “where a taxpayer seeks to claim tax benefits, unintended by the congress, by means of transactions that serve no economic purpose other than tax savings”

This doctrine questions whether the purported economic activity would have occurred absent the tax benefits claimed by the taxpayer

## 3 – Business purpose doctrine

- “A transaction will only be respected for tax purposes if it has economic substance which is compelled or encouraged by business realities ... and is not shaped solely by tax-avoidance features that have meaningless labels attached”
- The taxpayer was motivated by no business purpose other than to avoid tax or secure some tax benefit



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## 4 – Substance over form

“The result at the end of a straight path is not made different because it was reached by following devious path”

The doctrine looks at the substance of the transaction rather than the formal steps taken to implement it

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## 5 – Step transactions doctrine

- The doctrine “treats a series of formally separate steps as a single transaction if such steps are in substance integrated, interdependent, and focussed toward a particular result”
- The doctrine is used to determine “what really was going on with the transaction”.

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## Saudi Tax Law – Article 63

المادة الثالثة والستون : إجراءات مكافحة التجنب الضريبي

- أ - لغرض تحديد الضريبة للمصلحة الحق في : ...  
. إعادة تكييف المعاملات التي لا يعكس شكلها جوهرها ووضعها في صورتها الحقيقية.

### Measures against Tax Avoidance

(a) For the purposes of determining tax liability, the Department has the right: ...

(2) to reclassify according to its reality a transaction whose form does not reflect its substance

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## Consequences of using fake contract

- **Recent English court case**
- An IFI receives funds from an investor under an Investment Wakalah Contract
- Wakalah Contract provided
  - Anticipated profit
  - Incentive for the IFI in case profit is more than anticipated profit
  - Capital Guarantee
- Wakalah Contract approved by the Shari'ah Board
- IFI suffers a loss, refuses to pay
- The investors sues for the breach of the contract
- IFI lawyers argue that this contract is Haram, despite approval by SSB

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## Recent U.K. Court decision - 2

- The Court found that the "results of those rather **complicated** and **sophisticated** provisions were that any deposit would be at the specified rate of return, let us say for argument's sake 5 per cent. It could not be less than 5 per cent. It could not be more than 5 per cent. The wakeel, ..., was bound to pay that sum unconditionally and the depositor, ... under no circumstances had the right to any more than that sum". The Court noticed that, "...for all **intents and purposes the commercial result is equivalent to that of a deposit at interest**".

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## Recent U.K. Court Decision - 3

- The Court stated that the Wakalah contract was a "**device to enable** what would at least to some eyes appear to be the **payment of interest** under **another guise**, that is at least an **indirect practice of a non-Shari'ah compliant activity.**"

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## How to safeguard against faking

- Allah is merciful – there will be no need for faking to fulfil your halal and genuine needs
- All things are permitted, except that which is expressly forbidden
- Be careful, do not jump to forbid what is permissible and then start looking for a fake way out to meet your halal needs
- Base the hillah and hurmah reasoning on objectives of the Shari'ah – not on fixed formulas
- Comprehend the transaction and carefully identify the conflict with the Shari'ah prohibition
- Look into your ultimate intention and objectives
- The Prophet Muhammad(s) said, when in doubt ask your heart and when in doubt exercise restraint

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